May 22, 2014

Gerard Poliquin
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314–3428

RE: Comments on NCUA Proposed Rule: Prompt Corrective Action—Risk-Based Capital

Dear Mr. Poliquin,

We are credit unions over $40 million in assets located in seven Midwestern States that are exempt from the Member Business Lending (MBL) cap through the grandfathering provision that was provided when the MBL cap was adopted under HR 1151. We have a long, established and proven history of providing safe and sound agricultural lending to our members. We appreciate the opportunity to provide comment to the National Credit Union Administration (NCUA) with regard to the proposed amendments to Prompt Corrective Action—Risk-Based Capital.

Credit unions that serve rural America by making safe, low priced loans to farmers will be severely impacted by the risk-based capital rule if it is adopted as proposed. This negative impact is largely due to the tiered approach placed on member business loans. Looking at twenty-three credit unions in seven mid-western states that were grandfathered-in based on their history of agricultural lending, and therefore exempt from the MBL cap, illustrate the substantial impact that the proposed rule would have. The net increase in required capital for these twenty-three credit unions to maintain their buffer above well capitalized, moving from the current system to NCUA's proposal, is $199 million. In other words, the margin or buffer these twenty-three credit unions would have above being well capitalized would drop from $319 million to $120 million. However, if the Basel III Risk Weights were applied (which are quite similar for these credit unions to NCUA's except for the flat 100% on Ag loans,) the change in buffer or required capital is minimal, a total of $6 million, from $319 million to $314 million. (Not $5 because of rounding). Twenty two of those credit unions have signed onto this letter.

This proposed rule will inhibit the future of member business lending in the American Midwest. The proposed rule improperly treats all MBLs the same, grouping agricultural loans with construction loans. There are many credit unions in the Midwest that have an extremely long history in agricultural lending, with the expertise, operational processes and managerial oversight in place, and has been in place, to be very successful in making low-risk loans to their members. The proposed rule does nothing to take into account of how MBL risk is mitigated through the experience that these credit unions have. Furthermore, if the rule were to be finalized as proposed, many of these credit unions would have to cease or significantly modify their agricultural lending practices, thus removing another lender from the marketplace. In some rural locations in the Midwest, the credit union is the only agricultural lender. This proposed rule will hurt the consumer and the American farmer.

In the discussion of the proposed rule, the NCUA states, "because the FCUA requires the risk-based measure to include all material risks, consideration was given to credit risk, concentration risk, market risk, interest rate risk, operational risk, and liquidity risk." *79 FR 1194 (February 27, 2014).* As clearly found in the FCUA, the NCUA is not required to include ALL risks, only those that the "net worth ratio required for an insured credit union to be *adequately* capitalized may not provide *adequate* protection." *FCUA §216(d)(2)*

The NCUA has already adopted and implemented regulations that addresses a number of the risks that the NCUA now deems as "material" and required within the prompt corrective action proposed revisions. The proposed risk-weights that the NCUA claims is addressing these "material" risks is burdensome, duplicative and extremely unnecessary.

In September 30, 2012, the NCUA's rule requiring Interest Rate Risk (IRR) Policy and Program became effective. When the IRR was issued, NCUA wrote that it, "acknowledges both the range of IRR exposures at credit unions, and the diverse means that they may use to accomplish an effective program to manage this risk. NCUA therefore does not *stipulate specific quantitative standards or limits for the management of IRR applicable to all credit unions*, and does not rely solely on the results of quantitative approaches to evaluate the effectiveness of IRR programs. Assumptions, measures and methods used by a credit union in light of its size, complexity and risk exposure determine the specific appropriate standard." *[Emphasis added.] Appendix B to Part 741, Section VII*. However, now the NCUA seems to be contradicting itself by establishing thresholds of what is essentially acceptable levels of risk and placing soft caps on other risk by requiring significantly higher risk weights for categories the NCUA seems to deem unacceptable.

To address liquidity risk, the NCUA issued its final rule "Liquidity and Contingency Funding" in October 2013 which became effective March 31, 2014. In the discussion of this rule, the NCUA noted that "After careful consideration of the comments, the Board has concluded that a liquidity rule is necessary to ensure that FICUs remain resilient in times of economic stress." *78 FR 64880, October 20, 2013*. Again, there seems to be a contradiction. If the Liquidity and Contingency Funding was necessary to ensure resilience, it is difficult to accept an argument that another rule covering the same risk is also necessary.

It is our position that interest rate risk and liquidity risk do not remain a "material" risk when there are already regulations in place that address these issues in-depth and already require action of the credit union to manage these risks.

NCUA issued a Letter to Credit Unions, 10-CU-03, that included the enclosure, *Supervisory Letter – Concentration Risk*. This Supervisory Letter explains that "Credit union officials and management have a fiduciary responsibility to identify, measure, monitor, and control concentration risk." "It is up to credit union management to identify the risk in each product or service line, quantify the risk and set appropriate concentration limits based on the analysis." *NCUA 10-CU-03, Encl. Supervisory Letter – Concentration Risk, page 1.* Through this proposed rule, it appears that NCUA is now setting the concentration limit for credit unions, however, it is not taking account the factors that it itself recommended to credit unions to evaluate. Instead, the NCUA is taking a broad stroke approach and grouping all Member Business Loans into one bucket.

When evaluating credit union's management of risk, the NCUA examiners are directed to look at whether or not management has maintained and performed analysis of certain factors. These factors include "Origination and portfolio trends by product, loan structure, originator channel, credit score, LTV, debt-to-income ratio (DTI), lien position, documentation type, property type, appraiser, appraised value, and appraisal date; Delinquency and loss distribution trends by product and originator channel with accompanying analysis of significant underwriting characteristics, such as credit score, LTV, and DTI; Vintage tracking (i.e., static pool analysis); The performance of third-party (brokers, auto dealers, and correspondents) originated loans; and, Market trends by geographic area and property type to identify areas of rapidly appreciating or depreciating housing values." *NCUA 10-CU-03, Encl. Supervisory Letter – Concentration Risk, page 9.* These factors are ignored in the NCUA's proposed risk-based capital rule. A one-size fits all rule does not work! The credit union's management is in the best position to evaluate and determine its acceptable risk levels.

Through the supervisory and examination process, the NCUA already has controls in place to ensure a credit union is managing its concentration risk. For the NCUA to determine that concentration risk remains a "material" risk is in error. The tiered risk-weights of certain categories in the NCUA's proposed rule goes against its own recommendation to credit unions in evaluating risk. It does not consider any other factors within the broad category. This method is ineffective and harms credit unions. The NCUA cannot take a one-size fits all approach and ignore relevant mitigating factors.

As proposed, member business loans would be risk-weighted at 100 percent for MBLs less than or equal to 15 percent of assets; 150 percent for any MBLs greater than 15 percent of assets and less than or equal to 25 percent of assets; and 200 percent for the total amount of MBLs greater than 25 percent of assets, other than MBLs included in Category 3 (50 percent risk-weight). The NCUA reports that "only 70 of the credit unions holding MBLs have MBL portfolios in excess of 15 percent of total assets." *79 FR 11197, February 27, 2014*. As previously discussed, a number of these credit unions holding MBLs in excess of the 15 percent of total assets are located in the

Midwest. These are credit unions that serve predominately rural areas by offering agricultural loans. Basel III for small banks only apply risk weight of 100% for MBLs, regardless of the concentration. NCUA has not justified its reasoning for being more restrictive than banks.

The NCUA notes that "supervisory experience has demonstrated that certain MBLs present multiple risks for which credit unions should hold additional capital. Many of the largest losses to the NCUSIF occurred in credit unions with high concentrations of MBLs." *79 FR 11196, February 27, 2014*. In the preamble, the NCUA then cites to NCUA Office of the Inspector General, OIG-10-20, OIG Capping Report on Material Loss Reviews. (Nov. 23, 2010). The OIG-10-20 report notes that "Our MLR reports confirm overwhelmingly that credit union management's actions greatly contributed to the failure of each of the ten institutions reviewed by the OIG." Furthermore, the report states that "we identified examiner deficiencies in quality control efforts and examination procedures. We believe had examiners acted more aggressively in their supervision actions over these critical issues, the looming safety and soundness concerns that were present early-on in nearly every failed institution, could have been identified sooner and the eventual losses to the NCUSIF could have been stopped or mitigated." *OIG-10-20, page 2*. The NCUA should treat higher concentrations of MBLs with heightened scrutiny, rather than simply imposing oppressive capital requirements. With a 10.5% RBC ratio to be well capitalized, and a 200% risk weight, business loans over 25% of assets have an effective capital requirement of 21%.

In the *NCUA Office of the Inspector General, OIG-10-20, OIG Capping Report on Material Loss Reviews (Nov. 23, 2010)*, the report also discussed the MBL issues that were found in the affected credit unions. While it may appear on its face that some of the largest losses to the NCUSIF occurred in credit unions with high concentrations of MBLs, we cannot find any evidence that these concentrations were in agricultural lending.

In the OIG-10-20 report, it references a failed credit union that violated NCUA's MBL limits by failing to limit its aggregate net MBL balances. Furthermore, this particular credit union was engaged in out of state construction loans. Another reviewed credit union misclassified MBLs. Furthermore, examiners failed to recognize the borrower's intent was often misrepresented on the loan applications underwritten by the credit union's third-party provider. The report noted that in a third credit union, the MBL policy was inadequate. In another reviewed credit union, management violated numerous MBL regulatory limits. The report noted that for this particular credit union, "examiners needed earlier and stronger supervisory action, which may have influenced the credit union's Board and management to limit the significant level of risk assumed during the institutions rapid growth period…" In the fifth credit union reviewed, again management violated NCUA rules and regulations by continuing to make MBLs despite being undercapitalized. In another reviewed credit union, it *repeatedly* violated NCUA rules and regulation over member MBL limitations for construction and development loans, MBLs to one individual or associated group and aggregate MBLs. Finally, in the last reviewed credit union, the management did not have MBL policies in place despite having MBLs in the portfolio. *OIG-10-20, page 21-22.*

Nothing in this report would support the NCUA's position that risk-weights for higher concentration of MBLs, or more specifically, agricultural MBLs is needed or even warranted. We are credit unions that are operating within the NCUA's rules and regulation, and yet we are being treated the same as those credit union's whose management clearly had no business operating a credit union.

In the proposed rule, the NCUA attempts to support the proposed risk-weights for MBLs by citing to bank failures. "Similarly, the failures of many small banks between 2008 and 2011 were also largely driven by high concentrations of MBLs. The GAO reported that in the 10 states with 10 or more bank failures between 2008 and 2011, the failure of the small and medium-size banks were largely associated with high concentrations of commercial real estate loans." *79 FR 11196, February 27, 2014*. However, if one were to read that GAO report, the rest of the sentence provides a clearer picture. "In the 10 states with 10 or more failures between 2008 and 2011, failures of small and medium-size banks were largely associated with high concentrations of commercial real estate (CRE) loans, in particular the subset of acquisition, development, and construction (ADC) loans, and with inadequate management of the risks associated with these high concentrations." *U.S. Government Accountability Office, GAO-13-704T, Causes and Consequences of Recent Community Bank Failures (June 12, 2013), page 4.*

Furthermore, the report cited that "The rising level of nonperforming loans, particularly ADC loans, appears to have been the key factor in the failures of small and medium-size banks in the 10 states between 2008 and 2011." *GAO-13-704T, page 5*. "ADC loans generally are considered to be the riskiest class of CRE loans because of their long development times and because they can include properties (such as housing developments or retail space in a shopping mall) that are built without firm commitments from buyers or lessees. By the time the construction phase is completed, market demand may have fallen, putting downward pressure on sales prices or rents, making ADC loans more volatile." *GAO-13-704T, footnote 3.*

Again, this does not support the NCUA's proposed risk-weights for MBLs, especially lumping all MBLs together. It appears from the reports that the NCUA attempts to use as justification, that credit union and banks failed because of poor management and engaging in highly risky business loans. Should the NCUA pursue a tiered approach to MBLs risk-weights, the NCUA cannot group all MBLs in one bucket. To do so would be oppressive and unreasonable.

We acknowledge that the current system is not adequate, however, the proposed rule will have devastating effects on our credit unions and our members. If the proposed rule were finalized, coming into compliance would destroy profitability and reduce benefits to members. The sustainability of credit unions would also be called into question.

Thank you for this opportunity to share our comments.

Sincerely,

Midwest Agricultural Credit Union Coalition

Archer Cooperative Credit Union, Archer Nebraska

Beacon Credit Union, Wabash Indiana

Capital Credit Union, Bismarck North Dakota

Central Minnesota Credit Union, Melrose Minnesota

Citizens Credit Union, Devils Lake North Dakota

Community Credit Union, New Rockford North Dakota

Co-op Credit Union of Montevideo, Montevideo Minnesota

Dakota Plains Credit Union, Edgeley North Dakota

Dakota Plains Federal Credit Union, Lemmon South Dakota

Dakota West Credit Union, Watford City North Dakota

Dawson Co-op Credit Union, Dawson Minnesota

Farmway Credit Union, Beloit Kansas

First Community Credit Union, Jamestown North Dakota

Fulda Area Credit Union, Fulda Minnesota

Heartland Credit Union, Madison Wisconsin

Hometown Credit Union, Kulm North Dakota

Interra CU, Goshen Indiana

North Star Community Credit Union, Maddock North Dakota

Southpointe Federal Credit Union, New Ulm Minnesota

Town & Country Credit Union, Minot North Dakota

Western Cooperative Credit Union, Williston North Dakota