

April 23, 2015

Mr. Gerard Poliquin
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314

RE: NCUA Prompt Corrective Action – Risk Based Capital, second proposed rule; RIN 33133-AD77

Dear Mr. Poliquin:

Mid Minnesota Federal Credit Union (MMFCU) appreciates the opportunity to comment on NCUA's revised proposed rule for Prompt Corrective Action – Risk Based Capital (RBC2). MMFCU, with assets of approximately \$270 million, is a full-service credit union serving more than 38,000 members in nine rural counties in Central Minnesota. Our services include first and second mortgage lending, as well as, business services that includes business lending. MMFCU is a significant service provider in the communities that we serve, including business services.

MMFCU's position continues to be that the current rule for Prompt Corrective Action is sufficient and that the RBC2 is unnecessary. However, we also understand the NCUA Board's position that changes to the capital regulations are needed for the NCUA to better supervise the credit unions they regulate and to better protect the National Credit Union Share Insurance Fund (NCUSIF) from losses due to insufficient capital at some credit unions for the risks they undertake. MMFCU also believes that well-crafted regulations, promulgated within a regulatory agency's legal authority and consistently applied by the regulatory agency, can also serve to help a credit union strategically plan for the future. Therefore, MMFCU offers our comments for RBC2 for the NCUA Board's consideration.

First, MMFCU wishes to recognize the significant changes that the NCUA Board has made to the original rule proposal issued in 2014. The changes have addressed many of our concerns that we noted in our comment letter dated May 14, 2014. We are especially appreciative and supportive of the following improvements that the NCUA Board has made in the RBC2 proposal:

- Raising the threshold for “complex” credit unions, although we do have comments on this issue in this letter;
- Lowering the risk-based capital ratio requirement for a credit union to be considered “well capitalized” from 10.50% to 10.00%;
- Extending the implementation period to January 1, 2019, this will provide reasonable time for credit unions to plan and adjust for the new rule if the Board implements it;
- Removing the ALLL cap in calculating the risk based capital ratio;

- Improvements to the risk weights by lowering and diversifying them to be more logical and more in line with non-credit union financial institution regulations, although we do have a few comments on this issue in this letter;
- Improving the risk weights for commercial loans;
- Assigning one-to-four family non-owner occupied residential real estate loans the same risk weights as other residential real estate loans;
- Removing any risk weighting for consolidated CUSO investments if done according to GAAP and reducing the risk weightings for equity CUSO investments and CUSO loans;
- Removing Interest Rate Risk (IRR) as a factor in determining asset risk weights.

Before stating our specific comments on the RBC2 proposal, we would like to make the point that even the best crafted and most restrictive regulations cannot prevent credit union financial failures stemming from poor internal controls, poor Asset-Liability Management (ALM) policies and practices, and inadequate cyber security policies and practices, all of which require proper regulatory oversight within examination reviews. Any attempt by a regulator to address these issues through regulation is ill advised and will only have the effect of inhibiting growth, innovation, and, most importantly, preventing quality services from being provided to credit union members.

MMFCU will not comment on whether or not the NCUA's proposed regulation is legal under its authority, as some other commenters have argued, as this is a legal question and we are not in a position to weigh in on either side of this legal argument. However, MMFCU does believe that the NCUA needs to always be careful in interpreting its authority under law and should always seek legislative authority or clarification when the agency believes it needs more authority, or when the agency's authority is reasonably challenged.

Impact on MMFCU Capital

Should the proposed RBC rule be implemented today, MMFCU would still be considered "well capitalized"; however, our cushion of dollars of capital to maintain that designation would be negatively impacted. In addition, it could have an impact on our strategic plans for future growth, our ability to add incremental income, and our ability to achieve better asset diversification.

Based on our year-end 2014 balance sheet, our Net Worth Ratio was at 11.42% and our estimated Risk Based Capital Ratio would have been 15.37%, keeping MMFCU in the "Well Capitalized" category. However, if we had maximized our member business loans to 12.25% of assets, and used only CD investments to fund them, our estimated Risk Based Capital Ratio would fall to 14.79%.

702.101 – Capital Measures, Capital Adequacy, Effective Date of Classification, and Notice to NCUA

With regard to Section 701.101(b), dealing with capital adequacy, MMFCU agrees that a credit union should, "... maintain capital commensurate with the level and nature of all risks to which the institution is

exposed” and that a “... comprehensive written strategy for maintaining an appropriate level of capital” should be developed. Our concern here is how examiners will determine the “appropriate levels of capital” needed and any assessment of the “adequacy” of a written strategy. This can be open for interpretation with regard to how a credit union’s risk profile is determined. To mitigate this inevitable conflict between NCUA examiners and credit union management, we recommend that the NCUA clearly state within the regulation the minimum requirements for a strategy/plan (perhaps as a sample policy/plan within an appendix to the regulation) and that the regulation also include the appeals process that will be available to credit unions should any conflict over a strategy/plan in fact arise.

702.102 – Capital Classifications

MMFCU still supports the retention of the current definitions of “Well Capitalized,” “Adequately Capitalized,” “Undercapitalized,” “Significantly Undercapitalized,” and “Critically Undercapitalized.” That being said, however, MMFCU is appreciative of the Board’s thought process and reduction of the threshold for “Well Capitalized” from the original RBC proposed regulation of 10.50% to the current RBC2 proposed regulation of 10.00%.

702.103 – Applicability of the Risk-Based Capital Ratio

MMFCU is appreciative of the NCUA Board raising the threshold for defining a “complex” credit union from a credit union that simply has \$50 million in assets to one that has \$100 million in assets. Although, defining a credit union as complex simply by its asset size fails to recognize the true characteristics that make a credit union complex. There are numerous credit unions that are over \$100 million in assets, but operate with only basic services and avoid activities generally considered complex or risky. However, MMFCU understands that defining “complex” for purposes of avoiding placing undue regulatory burdens on smaller credit unions is perhaps the most pragmatic approach. Therefore, MMFCU supports defining “complex” by asset size, but questions if the threshold of \$100 million is still set too low. By raising the threshold asset size, even “non-complex” credit unions would have the resources to develop and monitor a capital strategy/plan that is commensurate with their risks (a larger credit union with little risky activity could have a very simple plan that should not be a burden). MMFCU recommends raising the definition of “complex” to \$500 million in assets or \$250 million in assets if the credit union engages in specific activities that the NCUA believes to be particularly risky and poses a true risk to the NCUSIF.

702.104 – Risk-based capital ratio measures

MMFCU acknowledges the NCUA Board’s positive changes from the original regulation proposal with regard to the risk weighting of assets. However, MMFCU still has concerns over certain parts of the RBC2 proposal for certain risk weights.

Category 2 – 20 percent risk weight – MMFCU believes that loans fully secured by member shares held within the credit union, or the portion of any member loan secured by member shares

held within the credit union, should have a risk weight of zero. Our rationale for this is that the credit union will not incur a loss of principal on the loan and any default would result in an equal reduction of the share liability, thereby, not effecting capital. It is our understanding that the bank regulators make this distinction in their risk weighted capital determination and there is no reason that credit unions should be treated differently.

Category 4 – 75 percent risk weight – With regard to current first-lien residential real estate loans that in aggregate exceed 35% of a credit union’s assets being placed into this risk weight category, MMFCU disagrees. We understand that concentrations in particular asset classes or loan types poses more risk to a financial institution, however, the concentration in of itself does not place these loans at any more risk of default than those risk weighted at 50%. MMFCU understands that, as stated within NCUA’s Supplementary Information Side-by-Side Analysis of the proposed RBC2, the NCUA Board has been advised by the NCUA Office of Inspector General (OIG) and the Government Accountability Office (GAO) to address concentration levels in regulation. However, MMFCU’s position is that this potential concentration issue is an ALM issue and should be handled as part of the examination review process and/or regulations regarding ALM. MMFCU recommends that the NCUA Board place all current first-lien residential real estate loans in the 50% risk weight category, regardless of asset concentration limits, as is done by the banking regulators.

Category 6 – 150 percent risk weight – With regard to current junior-lien residential real estate loans that in aggregate exceed 20% of a credit unions assets being placed into this risk-weight category, MMFCU disagrees. Again, we understand that concentrations in particular asset classes or loan types poses more risk to a financial institution, however, the concentration in of itself does not place these loans at any more risk of default than those risk weighted at 100%. MMFCU’s position is that this potential concentration issue is an ALM issue and should be handled as part of the examination review process and/or regulations regarding ALM. MMFCU recommends that the NCUA Board place all current junior-lien residential real estate loans in the 100 %risk weight category, regardless of asset concentration limits.

Category 7 – 250 percent risk weight – This risk-weight category only deals with the carrying value of mortgage servicing assets. MMFCU routinely sells mortgages to FNMA and the FHLB while retaining the servicing rights. This activity, we believe, is a sound management strategy for liquidity and ALM risks, while allowing us to create a revenue source and maintain the relationship with our members. Currently, MMFCU has over \$150 million of mortgages being serviced. This servicing activity, in accordance with GAAP, requires MMFCU to recognize the value of the servicing rights as an asset. MMFCU has a third-party vendor periodically analyze this asset, the underlying mortgage loans being serviced, to determine the asset value and the proper amortization of the asset. Once the analysis is done, the value calculated is compared to the current carrying value, and if the calculated value is less than the current carrying value, an adjustment to write-down the asset is made. In accordance with GAAP, should the analysis determine that the asset has a higher value than is currently carried, no adjustment is made, as GAAP does not permit recognition of gains on the asset value due to the analysis. This means that the risks noted in the published rule’s Section-by-Section Analysis are sufficiently mitigated

by following GAAP. Therefore, we believe that the proposed rule to impose a risk weight of 250% on this asset class is inappropriate, even though other bank regulators place a 250% risk weight on this.

MMFCU's reasoning is that the rule, as proposed, implies that this asset is riskier than any delinquent loan, any mortgage loan, or any member business loan. We strongly disagree with the logic stated within the Section-by-Section Analysis. Just because the banking regulators assigned this asset a 250% risk weight and it does not appear that the risk weighting has inhibited this activity, does not automatically make the risk weight appropriate. We believe that mortgage servicing assets should be weighted at no more than 100%, or at least tier it where credit unions that properly follow GAAP and periodically have third-party valuation calculations done have a risk weight of 100% and those that do not have third-party valuations done risk-weight the asset at 250%. Our logic for using tiers is what we have stated above, that properly following GAAP mitigates the risks. Just because the banking regulators have not made this connection, doesn't mean the NCUA should just follow along. Again, we strongly urge the NCUA to reconsider this risk weighting.

Member Business Loans – MMFCU appreciates and supports the proposed RBC2 change to the risk-weighting of Member Business Loans (MBLs). The proposed level of 100% risk-weighting for MBLs that in aggregate are less than 50% of a credit union's assets is appropriate. We also agree that the amount of MBLs that in aggregate exceed 50% of a credit union's assets should have a risk-weighting of 150%.

Treatment of Goodwill

MMFCU agrees with the comments of the Minnesota Credit Union Network with regard to the proposed RBC2 treatment of goodwill as stated in their comment letter dated April 7, 2015. While the rule change does not have an immediate impact on MMFCU, we understand the importance of providing for goodwill when dealing with the merger of a troubled credit union and the impact not having goodwill as part of the RBC2 calculation. Failing to recognize the legitimate value of goodwill, which is carried in accordance with GAAP, can have the consequences of negatively impacting the NCUSIF in order to complete a distressed merger situation. MMFCU asks for the NCUA Board to reconsider its position with regard to goodwill and allow goodwill to be included in the numerator of the ratio formula without a sunset date.

Supplemental Capital

MMFCU generally supports the introduction of supplementary capital for the purposes of calculating a risk based capital ratio. It is our understanding that this is within the NCUA Board's authority and we ask the NCUA Board to include this in the final RBC2 rule. MMFCU also encourages the NCUA Board to seek from Congress the authority to have credit unions have some form of supplementary capital that can be counted as net worth for the purposes of prompt and corrective action.

Interest Rate Risk

MMFCU supports the NCUA Board's decision to not include IRR as part of the RBC2 proposal. The NCUA Board has asked for comments on approaches that the NCUA can take to measure and monitor IRR at credit unions appropriately.

MMFCU believe these tools already exist in requirements for IRR policies and guidance letters issued by the NCUA, which are used during the NCUA examination process to assess a credit union's ability to measure and manage IRR. Additional regulation in this area will not result in better regulatory monitoring, nor will it adequately capture these risks on a consistent basis. We do not see the benefit of mandating specific IRR measurement tools as appropriate since these tools, like NEV, can have vastly different outcomes due to different assumptions being made. It seems to us that only on-site reviews by the NCUA examination force of the tools used to manage a credit union's IRR can be effective. MMFCU is reluctant to provide more specific details on any regulatory oversight in this area as there are many "experts" in ALM that can provide better guidance. Should the NCUA Board pursue promulgating regulations in this area, we would welcome the opportunity to review and comment on them at that time.

Conclusion

MMFCU again thanks the NCUA Board for the opportunity to comment on the proposed RBC2 rule and appreciates that the NCUA Board and its staff has addressed the numerous issues commented on with regard to the original RBC rule issued by the NCUA Board in 2014.

MMFCU has had the opportunity to review the comments made by the Minnesota Credit Union Network in their letter dated April 7, 2015 regarding RBC2 and we are in full support of their comments as well. We thank you for your consideration of our comments on this issue and ask that the NCUA Board and its staff again take into consideration all comment letters received.

Sincerely,

Charles Albrecht
President/CEO

cc: MMFCU Board
MMFCU Asset-Liability Committee
MMFCU Supervisory Committee
MMFCU Senior Management
Minnesota Credit Union Network

Senator Amy Klobuchar
Senator Al Franken
Representative Collin Peterson
Representative Rick Nolan