April 27, 2015

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

RE: RIN 3133–AD77; Risk-Based Capital

Dear Mr. Poliquin,

The Credit Union Association of the Dakotas (CUAD) appreciates the opportunity to provide comment to the National Credit Union Administration (NCUA) with regard to the proposed amendments to Risk-Based Capital. To provide a brief background, the Credit Union Association of the Dakotas represents sixty-nine state and federally chartered credit unions in the states of North Dakota and South Dakota, whose assets total over $5.9 billion and who have more than 450,000 members.

CUAD appreciates the NCUA's thorough review of the comment letters submitted in response to the first proposed rule regarding risk-based capital. In North and South Dakota we have a number of credit unions that have a long, established and proven history of providing safe and sound agricultural lending to their members and application of the first proposed rule would have been detrimental to our credit unions' members and communities had it been adopted as first proposed. We thank the NCUA for listening to these comments and making significant changes to the proposed rule and issuing it for a second round of comments. However, CUAD and our members still have a number of concerns regarding this second proposed risk based capital rule which are discussed below.

The Federal Credit Union Act (FCUA) §216(a)(1) provides that the purpose of Prompt Corrective Action is to "resolve the problems of insured credit unions at the least possible long-term loss to the Fund." The FCUA directs the NCUA Board to prescribe a system of prompt corrective action for insured credit unions through regulation. However, the FCUA also directs that NCUA Board to take into account "that credit unions are not-for-profit cooperatives that (i) do not issue capital stock; (ii) must rely on retained earnings to build net worth; and (iii) have board of directors that consist primarily of volunteers." FCUA §216(b)(1)(B).

CUAD appreciates the NCUA's role and responsibility to protect the share insurance fund and also to ensure safety and soundness in credit unions. CUAD also acknowledges that the NCUA is directed to implement regulations for prompt corrective action. However, CUAD is concerned that attempting to develop a one-size-fits all risk-based capital rule will only impede credit union growth and sustainability. Credit unions are obviously not banks and in developing rules and regulations it is imperative that the NCUA not lose focus of the fact that credit unions are not-for-profit cooperatives that do not issue capital stock; must rely on retained earnings to build net worth; and have board of directors that consist primarily of volunteers.

In the discussion to the proposed rule the NCUA states that, "based on December 2013 Call Report data, NCUA estimates over 98 percent of credit unions with over $100 million in assets already have sufficient capital to remain well capitalized under this proposal. NCUA estimates this proposal (based on December 2013 data) would cause fewer than 20 credit unions (with total assets of $10.9 billion) to experience a decline in their capital classification from well capitalized to adequately capitalized." *80 FR 4424, January 27, 2015*. CUAD questions the need for this detailed and burdensome regulation if only twenty credit unions will be immediately impacted, while all credit unions with over at least $80 million in assets (based on the proposed $100 million threshold becoming effective in 2019) will need to make changes to systems and potentially their strategic plans. It appears that an alternative to requiring the credit union industry to expend the time, energy and money to implement the proposed rule (including the NCUA's own cost in changes to call reports and systems) is for the NCUA to work directly with these twenty credit unions to resolve any perceived issues concerning risk and capital levels.

The NCUA should use a modelling tool rather than an inflexible and rigid rule, such as the monitoring tools that NCUA is using for interest rate risk. This would be far more successful at managing risk as examiners, boards and managers could calculate risk-based capital using risk weights appropriate for an individual credit union's environment. A flexible modelling tool would also allow the NCUA to adjust weightings as conditions change to evaluate the impacts particular to individual credit unions. CUAD is concerned that a one-size-fits all rule will not give an accurate picture of what may or may not be "risky" within an individual credit union.

Defining "complex" credit union.

Proposed § 702.103 would provide that a credit union is defined as ''complex'' and the risk-based capital ratio measure is applicable only if the credit union's quarter-end total assets exceed $100,000,000, as reflected in its most recent Call Report. The FCUA §216(d)(1) directs the NCUA to define complex based on "portfolios of assets *and* liabilities of credit unions." [*Emphasis added*.] The NCUA's second proposed rule continues to only define a complex credit union based on assets and does not include liabilities as directed by the FCUA. Under current regulations, a credit union is defined as "complex" and a risk-based net worth requirement is applicable only if the credit union meets *both* "(a) Minimum asset size. Its quarter-end total assets exceed fifty million dollars; AND (b) Minimum RBNW calculation. Its risk-based net worth requirement as calculated under §702.106 exceeds six percent (6%).” *12 CFR 702.103*

The NCUA is improperly identifying “complex” credit unions based only on asset size and not per the directives of the Federal Credit Union Act. However, should the NCUA find legal authority that would allow credit unions to be defined as “complex” based only on asset size, the threshold needs to be significantly increased to narrow the scope of potentially “complex” credit unions. CUAD continues to recommend that this threshold be increased to at least $1 billion and these credit unions work directly with NCUA in a cooperative manner to develop a risk based capital plan that is better suited for the credit union industry and will not jeopardize the future of credit unions.

Interest Rate Risk (IRR)

The NCUA is excluding consideration of IRR from the risk-based capital ratio measure, but as discussed in the proposed rules, in the future intends to consider alternative approaches for taking into account the IRR at credit unions. The proposed methodology for assigning risk weights in this proposed rule would account only for credit risk and concentration risk.

Alternative approaches to addressing IRR that the NCUA is considering include adding a separate IRR standard as a subcomponent of the risk-based net worth requirement to complement the proposed risk-based capital ratio measure. Per the NCUA, “a separate IRR standard should be based on a comprehensive balance sheet measure, like NEV, that takes into account offsetting risk effects between assets and liabilities (including benefits from derivative transactions). The intent of such a measure would be to measure IRR consistently and transparently across all asset and liability categories, to address both rising and falling rate scenarios, and to supplement the supervisory process with a measure calibrated to address severe outliers.” *80 FR 4356, January 27, 2015*.

CUAD supports the NCUA’s removal of IRR from the risk based capital ratio measure, however, CUAD is opposed to any future rulemaking that involves interest rate risk as the NCUA has already issued regulations on this topic and any further involvement by the NCUA concerning IRR should be left at the supervisory level. In September 30, 2012, the NCUA’s rule requiring IRR Policy and Program became effective. Section 741.3(b) requires that certain factors be considered in determining whether the credit union’s financial condition and policies are both safe and sound. One of these factors is “the existence of a written interest rate risk policy (“IRR policy”) and an effective interest rate risk management program (“effective IRR program”) as part of asset liability management. Federally insured credit unions with assets of more than $50 million, as measured by the most recent Call Report filing, must adopt a written IRR policy and implement an effective IRR program.”

In its regulations, the NCUA wrote, "NCUA 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*.

"Well capitalized" classification.

Under the proposed rule, except for credit unions defined as ''new'', a credit union would be classified "Well capitalized if: (i) Net worth ratio. The credit union has a net worth ratio of 7.0 percent or greater; and (ii) Risk-based capital ratio. The credit union, if complex, has a risk based capital ratio of 10 percent or greater." *80 FR 4432, January 27, 2015*.

The FCUA provides that "The Board shall design the risk-based net worth requirement to take account of any material risks against which the net worth ratio required for an insured credit union to be *adequately* capitalized may not provide *adequate* protection." [Emphasis added.] *FCUA §216(d)(2)*. The FCUA does not specify what risks these are, however, it is does indicate that the NCUA include ONLY those material risks against which the risk-based net worth requirement for an *adequately* (not well) capitalized insured credit union may not provide *adequate* protection.

NCUA continues its position that it has legal authority to develop a tiered method thereby requiring additional capital requirements beyond what is required for a credit union to be adequately capitalized. The plain language of the Federal Credit Union Act clearly <u>only</u> allows for risk-based net worth requirements for an insured credit union to be <u>adequately</u> capitalized. The FCUA does not authorize the NCUA to impose any additional risk-based net worth requirement for well-capitalized credit unions.

The NCUA needs to operate within the confines of the Federal Credit Union Act, just as credit unions must do, and cannot exceed the authority given to it by Congress. If NCUA determines that risk-based net worth requirements must apply to well-capitalized credit unions, then Congress must grant NCUA that authority before it proceeds with any regulatory rulemaking.

CUAD requests that the NCUA revise the definition of "well-capitalized" to require a credit union to have a net worth ratio of 7.0 percent or greater; and the credit union, if complex, have a risk based capital ratio of 8 percent or greater.

Capital Adequacy strategy

The proposed rule would add new requirements under § 702.101 regarding capital adequacy. "(1) Notwithstanding the minimum requirements in this part, a credit union defined as complex must maintain capital commensurate with the level and nature of all risks to which the institution is exposed. (2) A credit union defined as complex must have a process for assessing its overall capital adequacy in relation to its risk profile and a comprehensive written strategy for maintaining an appropriate level of capital." *80 FR 4431, January 27, 2015*.

The NCUA explains that the proposed rule, "is calibrated to be the minimum regulatory capital standard. Therefore, the NCUA believes it is necessary to incorporate a broader regulatory provision requiring complex credit unions to maintain capital commensurate with the level and nature of all risks to which they are exposed, and to *maintain a written strategy* for assessing capital adequacy and maintaining an appropriate level of capital. This provision would not affect a complex credit union's PCA classification. It would, however, support NCUA's assessment of complex credit unions' capital adequacy in the supervisory process (e.g., assigning CAMEL and risk ratings). NCUA would develop and publish supervisory guidance for examiners and credit unions on the application of this provision." *80 FR 4358, January 27, 2015.*

CUAD is opposed to any regulatory requirement for a credit union to maintain capital above what would be required for adequately capitalized credit unions as authorized by the FCUA. A regulatory requirement to necessitate additional capital is beyond the authority granted to the NCUA by Congress through the FCUA. CUAD is also opposed to any regulatory requirements for a credit union to have a "comprehensive written strategy." This regulatory requirement would subject credit unions to an individual examiner's scrutiny and subjective opinion.

Strategic planning is already in place within credit unions. Strategic planning maps out the course a credit union will take to reach their long-term goals, which typically will include a buffer for additional capital to stay above regulatory requirements. This plan should not be subject to examiner review. NCUA needs to remove this provision from the proposed rule.

Implementation Period

The NCUA is proposing to make the implementation date of this rule January 1, 2019, to provide both credit unions and NCUA sufficient time to make the necessary adjustments, such as systems, processes, and procedures, and to reduce the burden on affected credit unions in meeting the new requirements.

CUAD has concerns regarding the pending Financial Accounting Standards Board (FASB) changes to replace the current credit impairment model with a Current Expected Credit Loss model. Any final rule issued by FASB will require NCUA and FASB harmonization with respect to forecasting models utilized by credit unions to reduce conflicts between examination guidance. CUAD urges the NCUA to delay implementation of any final risk based capital rule until the final FASB rule has been fully implemented by credit unions.

Secondary Capital

In this proposed rule, the NCUA declines to permit credit unions (other than low-income credit unions) to include other supplemental forms of capital in the risk-based capital ratio numerator, pending potential Congressional action. In the discussion of the proposed rule, the NCUA notes that "at this time the Board prefers to await the outcome of previously proposed legislation that, if passed by Congress, would expressly authorize supplemental capital as a component of net worth, and permit the Board to decide whether or how to include such capital in the net worth ratio and the risk-based net worth requirement." *80 FR 4383, January 27, 2015*.

CUAD urges the NCUA to explore all options in which secondary/supplemental capital may be included in the numerator of the risk-based capital ratio now, prior to action by Congress, while still acting within the parameters of the FCUA. CUAD believes it is crucial that credit unions be allowed ready access to additional secondary capital. Whatever form that secondary capital eventually takes on, the final rule should take all forms of credit union capital into account as part of the risk-based capital ratio.

Risk Weights

CUAD continues to have concerns with several of the proposed risk weights. With regard to the proposed risk weights for credit union service organizations (CUSO), the proposed rule would require a 100% risk weight for loans to CUSOs and 150% risk weight for equity investments in CUSOs. The NCUA did propose new definitions for both these categories, specifically, "*Loan to a CUSO* means the outstanding balance of any loan from a credit union to a CUSO as recorded on the statement of financial condition in accordance with GAAP." *80 FR 4429, January 27, 2015*, and "*Equity investment in CUSOs* means the unimpaired value of the credit union's equity investments in a CUSO as recorded on the statement of financial condition in accordance with GAAP." *80 FR 4428, January 27, 2015*.

NCUA itself, best described CUSOs in its CUSO final rule published in the Federal Register on December 3, 2013, when it said "CUSOs provide significant value to the credit union industry by acting as a collaborative means to share risk, manage costs, and deliver services to credit union members. With their unique collaborative business model, CUSOs foster cooperation and shared innovation for credit unions to achieve economies of scale, retain expertise, and better serve their members. Thus, the NCUA Board (the Board) recognizes that CUSOs benefit both credit unions and credit union members." *78 FR 72538, December 3, 2013*. The FCUA already places restrictions on how much a Federal Credit Union may invest in or loan to a CUSO. The NCUA needs to be careful not to create a disincentive for credit unions to collaborate through CUSOs. CUSOs serve an extremely important role in the credit union industry and limiting that access will harm the credit unions' members and the communities they serve.

CUAD continues to believe that the 250% risk weighting for mortgage servicing assets (MSAs) remains too high and should be significantly lowered to no more than 100%. The proposed rule defines mortgage servicing asset to mean "those assets, maintained in accordance with GAAP, resulting from contracts to service loans secured by real estate (that have been securitized or owned by others) for which the benefits of servicing are expected to more than adequately compensate the servicer for performing the servicing." *80 FR 4430*. While there is risk in MSAs if the member refinances or prepays their mortgage loan, that same risk would be present for loans held in house. First mortgage loans are only assigned a risk-weight of 50% to 100%. There are many other risks present when the mortgage loan is held in house in addition to the minimum risk of the member refinancing or prepaying the mortgage loan.

The NCUA is proposing a number of new risk weight categories. One of the new categories proposed would assign specific risk weights to all loans meeting the new definition of "commercial loans" and not apply risk weights based on the statutory definition of Member Business Loans. Under the proposed rule, "*Commercial loan"* means "any loan, line of credit, or letter of credit (including any unfunded commitments) to individuals, sole proprietorships, partnerships, corporations, or other business enterprises for commercial, industrial, and professional purposes, but not for investment or personal expenditure purposes. Commercial loan excludes loans to CUSOs, first- or junior-lien residential real estate loans, and consumer loans." *80 FR 4428, January 27, 2015*.

The proposed rule will require credit unions to provide more detail regarding information that is currently reported on the Call Report and to provide information on new categories not currently required in the Call Report. Call reports are already very complex. Core data processors will need to be modified to be able to supply the additional information required under the proposed definition of "commercial loan" in addition to the other changes required by the proposed rule. Changes to data processing systems are not easy nor cheap.

CUAD recommends that NCUA allow credit unions the option of voluntarily providing the additional information proposed in this rule. This voluntary approach can be accomplished by including optional data fields within the Call Report.

Conclusion

CUAD recognizes and appreciates the NCUA efforts to listen to the credit union industry by reviewing comments letters issued in response to the first risk based capital proposed rule and subsequently issuing a second proposed rule regarding risk based capital. CUAD also acknowledges the NCUA's role in protecting the share insurance fund and ensuring the safety and soundness of credit unions. CUAD urges the NCUA to take a pragmatic approach to this issue by issuing a modelling system that is flexible, less restrictive and takes into account that not all products in one particular category are created equal.

Thank you for this opportunity to share our comments and concerns.

Respectfully,

Robbie Thompson

Robbie Thompson
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Amy Kleinschmit

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