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April 7, 2015

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

Comments submitted via Federal eRulemaking Portal: www.regulations.gov

RE: Prompt Corrective Action - Risk-Based Capital, second proposed rule; RIN 3133-AD77

Dear Mr. Poliquin:

Please accept this correspondence as commentary concerning the National Credit Union Administration's (NCUA) second proposed rule to establish risk-based capital requirements for federally-insured credit unions. The Minnesota Credit Union Network ("MnCUN") appreciates the opportunity to comment on the revised risk-based capital ("RBC2") proposed rule and work collaboratively for the benefit of the credit union industry. By way of background, MnCUN represents the interests of Minnesota's 128 credit unions and their 1.6 million members.

First, MnCUN would like to acknowledge NCUA's significant efforts and work in addressing the issues raised by the approximate 2,000 comment letters it received on the initial risk-based capital proposal, as well as the views expressed during the NCUA's summer 2014 listening sessions. Thank you for listening to and addressing many of our concerns.

We are supportive of the following improvements reflected in the second proposed rule:

- Raising the applicable "complex" credit union asset threshold to $100 million;
- Lowering the ratio requirement for well-capitalized credit unions from 10.5% to 10%;
- Extending the implementation period to Jan. 1, 2019;
- Removing the ALLL cap;
- Removing interest rate risk as a consideration factor;
- Diversifying and lowering many of the risk-weight categories.

While we view many of the proposed changes to the revised-risk based capital rule as positive, we continue to have concerns around certain elements of the risk-based capital rule.

MnCUN appreciates NCUA's intention to help credit unions better absorb losses, establish a safer and more resilient credit union industry, and reduce risk to the National Credit Union Share Insurance Fund ("NCUSIF"). And, MnCUN generally supports a modern, detailed and robust capital system that is thoughtfully implemented over time. We understand that as the credit union industry grows, the need for a more sophisticated system to measure capital and risk to the NCUSIF will continue to be evaluated. However, considering how well credit unions generally weathered the most recent recession, we continue to question the necessity for the breadth and depth of the proposed risk-based capital regulation.

The greatest losses to the NCUSIF have been related to a lack of internal controls, which risk-based capital is not intended to address. We continue to question whether the costs of implementation justify the expected losses prevented by a risk-based capital rule, as well as the added regulatory burden upon the credit union industry which by and large is in optimal health.

Although the Federal Credit Union Act (FCUA) directs the NCUA to devise a risk-based capital requirement that is comparable to the Basel III bank system, the FCUA also directs NCUA as part of the process to take into account the unique nature of credit unions. FCUA specifically directs NCUA, when designing any prompt corrective action (PCA) regulation, to take into consideration that credit unions: are cooperatives, do not issue stock, must rely on retained earnings to build net worth, and have a board of directors that are primarily volunteers.

Because these factors are so important to the character and nature of a PCA regulation, it is unclear how NCUA has in fact taken into consideration the cooperative nature of credit unions. This unknown is further exacerbated when it is clear that Basel III does in fact use lower risk-weightings in certain categories as applied to banks than what NCUA's proposed risk-based capital risk-weights would apply to credit unions.

At a minimum, we would request that NCUA further expand on and explain how it took into consideration the FCUA's directives when crafting the risk-based capital regulation. While both the original proposal and the second proposal acknowledge in the legal authority sections that such factors were required to be taken into consideration, such directives should be the lens through which NCUA approaches all of the individual aspects of the proposed regulation, including risk weights. The current proposed regulation continues to be absent of this perspective.

Notwithstanding the foregoing comments, we anticipate that NCUA intends to move forward with risk-based capital in some form, and therefore we would respectfully offer the following additional commentary regarding the proposed risk based capital regulation.

Definition of "complex" credit union
MnCUN believes it was appropriate that the asset threshold to meet the definition of "complex" credit union was increased from $50 million to $100 million. We understand that defining a credit union as "complex" by asset size alone is likely the simplest and most predictable method of measure.

We continue to question, however, whether asset size alone should dictate the definition of "complex." It is illogical that there is a direct correlation between asset size and complexity. When determining whether or not a credit union meets the definition of complex, NCUA should consider more than just asset size. Such consideration should include a credit union's comprehensive book of assets, including all loans, investments, and liabilities, as well as whether a credit union's operations are sufficiently diverse to warrant a "complex" designation.

Comprehensive Written Strategy (Part § 702.101 (b)(2))
The revised risk-based capital proposal now requires a credit union that is subject to the regulation maintain a "comprehensive written strategy" for maintaining an appropriate level of capital. However, the regulation is decidedly absent of additional explanation regarding the expectations for this plan. What are the components of a "comprehensive written strategy"? What are the possible consequences of an examiner determining that a credit union's comprehensive written strategy does not meet the requirements? We ask NCUA to provide more description in this area and elaborate on its expectations of credit unions.

Goodwill
MnCUN continues to be concerned that the use of goodwill, although it will now be permitted in the calculation of a credit union's risk-based capital ratio when due to supervisory mergers through the effective date of the regulation, will be subject to a phase-out.

MnCUN continues to be concerned with the potential unintended consequence of this treatment. If a well-situated credit union relies on goodwill as a component of a merger, and is no longer able to justify such as a business decision because of a lack of allowance for goodwill, NCUA is then forced to step-in - which negatively impacts the NCUSIF, and further results in payment of additional premiums by all credit unions. Use of goodwill allows a well-situated credit union to absorb a struggling credit union without negatively impacting the NCUSIF, which as an industry we must find a way to continue to incentivize.

Goodwill should not be immediately deducted from the numerator of the risk-based capital ratio. Goodwill arising from both previous and future mergers should continue to be counted without a time limitation, so long as it meets GAAP requirements.

Risk Weights
NCUA did make significant improvements to the risk-weight categories from the original risk-based capital proposal, and many of the adjustments and more detailed categories are a significant improvement in the revised proposal.

Although similarities exist between the risk weights of the proposed rule and the Basel III requirements for banks, we continue to be concerned that the revised risk-based capital proposed risk-weights on credit unions are in some cases more restrictive than the Basel III requirements for banks. In comparing the categories and their risk weightings, credit unions under the proposed rule will still fall under higher risk-weight requirements than those required for banks in the same asset categories. The following are some of the risk-weight areas of concern:

- Share secured loans for credit unions are risk-weighted at 20%, and similar bank loans are risk-weighted at 0%. Likewise, the portion of a commercial loan balance secured by a contractual compensating balance is also assigned a 20% risk-weight for credit unions. Credit unions do not want to be treated less favorably than banks, and no reasoning has been provided for credit unions to be required to hold capital against any share-secured loans.
- Current first real estate loans greater than 35% of assets for credit unions are risk-weighted at 75%, and banks are risk-weighted at 50%.
- Current junior real estate loans, non-current junior real estate loans, commercial loans, are all assigned higher risk-weights at higher concentration levels for credit unions as opposed to the risk-weights on banks under Basel III. In certain cases, the risk-weights are overall more stringent on credit unions.
- Mortgage servicing assets continue to be risk-weighted at 250%. Although this is an equivalent to the FDIC risk-weight on banks, it still seems higher than necessary considering the cooperative nature of credit unions. If a credit union is following GAAP, it must record mortgage servicing as an asset that then requires a valuation be done every year, and if as an asset it does not meet the actual valuation reflected it must be written down to the audited value.

In particular, we also continue to have issue with the use of the concentration escalators for certain categories of risk-weights. It would be beneficial to be provided with what underlying information NCUA used to conclude that higher concentrations of certain assets should result in higher risk-weights.

We would continue to suggest that it would be beneficial for NCUA to provide evidence-based information that incorporates the underlying analysis, including any historical data used, on how types of risk-weight categories were assigned. While NCUA may have undertaken significant analysis and research to determine the various risk-weight categories, such analysis has not been provided as part of either the original or revised proposed rule. Credit unions would be better served if NCUA would provide the basis for assigning certain risk-weight categories.

In addition to providing empirical data and analysis regarding the risk-weights, MnCUN would again request that NCUA more thoughtfully consider the actual market effect on the credit union industry, produce more reasonably calibrated risk-weights based on the cooperative nature of credit unions, and reconsider the value of concentration escalators. In terms of concentration escalators specifically, we would request some empirical data that reflects what actual additional risk is created based on concentration of certain asset categories.

Interest Rate Risk

NCUA did not include interest rate risk in the revised risk-based capital proposal, which we support as appropriate to remove from the original proposal. NCUA did request, however, commentary on how the agency might address interest rate risk in the future.

Credit Unions are already regulated today on interest rate risk, and NCUA has provided significant guidance in the form of various letters to credit unions, and the agency's significant resources on its interest rate risk resource page. Through the examination process, examiners generally provide effective guidance on interest rate risk as it pertains to the specific credit union under examination. Because there are a number of assumptions and factors at play when considering interest rate risk, continuing to address interest rate risk through the examination process seems to be the most effective and appropriate approach. We would encourage NCUA to continue to manage interest rate risk through the examination process.

Generally, an attempt to address interest rate risk through the regulatory process seems cumbersome and difficult considering the many varying factors that are credit union specific. Should NCUA release any proposed regulation covering interest rate risk, we would anticipate careful review and providing comment on such a proposal.

Supplemental Capital

While supplemental capital has not been added specifically to the revised risk-based capital rule, we anticipate that it will continue to be an issue for discussion as it related to risk-based capital.

A credit union's access to additional supplemental capital outside of retained earnings will continue to be an ongoing area of discussion and exploration, and a possible area of additional regulation, in the credit union industry. We continue to believe that it is imperative to consider allowing credit unions ready access to additional secondary capital. It is particularly important as risk-based capital goes into effect, as credit unions are at a disadvantage in the financial market because of lack of access to additional capital outside of retained earnings.

Whatever form that supplemental capital eventually takes on, any risk-based capital regulation should take any form of credit union capital into account as part of the risk-based capital ratio, and the regulation should recognize that "capital is capital."

Final Thoughts For Consideration

Again, thank you for the significant improvement in the revised risk-based capital proposal, and for listening to the credit union industry's thoughts, ideas and concerns.

No risk-based capital system can be created that will hedge all risks and account for all potential loss scenarios. Regardless of best efforts on NCUA's part, there will continue to be credit unions that fail due to events outside of NCUA's control. However, regulations must balance potential losses with a credit union's need to develop appropriate services and strategic plans that best serve its membership. In order for the industry to remain strong, in addition to regulation there has to remain room for credit unions to evolve, grow and succeed. In the final revised risk-based capital proposed rule, we would encourage NCUA to re-evaluate and contemplate the directives given by the FCUA to take into the account the cooperative character of credit unions when imposing any prompt corrective action regulation.

If you have any questions about our comments, please do not hesitate to contact me at (651) 288-5170.

Sincerely,

John Wendland
General Counsel