the SUMMIT FEDERAL CREDIT UNION

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May 28, 2014

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

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

Dear Mr. Poliquin:

On behalf of The Summit Federal Credit Union, a federal credit union with $725 million in assets and 76,550 members located in Rochester New York, I am writing to you regarding the proposed rule on prompt corrective action and risk-based capital. We have serious concerns with implementing the proposed regulation, which we believe contains inconsistencies throughout the proposal in balance sheet treatment, would be difficult from a strategic planning standpoint due to the discretionary components of the proposed calculation, and would have a detrimental impact on the industry. Additionally, the ratings on certain components of the balance sheet seem overly conservative. We ask that the NCUA Board withdraw the rule or make major modifications to the proposal before any rule is finalized.

In summary, The Summit's primary concerns with the proposed regulation, which will be detailed later in this document, are as follows:

- The treatment of Goodwill assets in the risk based capital calculation
- The treatment of the National Credit Union Share Insurance Fund (NCUSIF) deposit in the risk based capital calculation
- The risk weighting for Other Real Estate Loans and Delinquent Real Estate Loans
- The risk weighting of Mortgage Servicing Rights
- The risk weighting for CUSO investments
- The proposal for examiner discretion in the calculation of risk based capital requirements
- The proposed time line for implementing the new regulations

## Goodwill

We believe that removing Goodwill from the numerator and denominator of the risk based capital calculation has the impact of treating all Goodwill as having absolutely no real value and writing it all off immediately. This is completely at odds with the accounting treatment required under Generally Accepted Accounting Principles (GAAP), which requires that Goodwill be written down as it is impaired. Goodwill assets are primarily recorded in credit union merger transactions, so the rule will negatively affect credit unions that have had recent mergers by failing to allow them to fully realize the previously accounted for benefit. In the future, the proposed treatment of Goodwill will present a disincentive for healthy credit unions to become merger partners for troubling or failing credit unions because of the possible significant negative effect to their risk-based net-worth ratio. We strongly recommend that Goodwill not be deducted from the numerator for the risk-based capital ratio, and treated as a risk asset with a weight of 100 in the denominator.

## National Credit Union Share Insurance Fund (NCUSIF) Deposit

We believe that removing the NCUSIF Deposit from the numerator of the risk based capital calculation has the impact of treating all NCUSIF Deposits as having been, in effect, written off as having no value at all. Due to the unique cooperative nature and structure of the NCUSIF fund, we believe this sends the wrong message to the entire financial institution industry, to the legislative branch of the government, and to credit unions. The 1% deposit is fully refundable should a credit union choose to disband or convert charters. This is an asset that has considerable value, and although at some level of risk due to potential losses, there is no indication that this deposit would ever be a 100% loss to any credit union. We strongly recommend that the NCUSIF Deposit should be not be deducted from the numerator for the risk-based capital ratio, and treated as a risk asset with a weight of 100 in the denominator.

## Other Real Estate Loans and Delinquent Real Estate Loans

NCUA's proposed rule uses the Other Real Estate Loans and Delinquent Real Estate Loan risk-weights to compensate for concentration risk by increasing the risk-weights to correspond with the percentage of those assets held by the credit union in its portfolio. For example, a non-delinquent variable rate home equity loan would carry a risk weight of at least 1.00 (if less than 10% of assets) and up to 1.50 (if in excess of 20% of assets). This compares to a risk weighting of between .50 – 1.00 for a non-delinquent first mortgage loan or .75 for a non-delinquent VISA or car loan. This seems to be penalizing credit unions who have chosen to keep home equity loans, which carry less interest rate risk, on their balance sheets versus long term fixed rate mortgages. The Summit has experienced very low loan losses on our home equity portfolio, so to weight home equity loans with a higher risk weighting than unsecured consumer loans seems unacceptable. Additionally, many members are able to utilize home equity loans to have a loan with tax deductible interest so that any disincentive for credit unions to make home equity loans could have the unintended consequence of hurting consumers directly by increasing their taxes and indirectly via turning to alternative loan types with higher interest rates. We would recommend the following risk weighted for Other Real Estate Loans and Delinquent Real Estate Loans:

- < 25% of assets: risk weight of .75
- Excess of 25% assets: risk weight of 1.00

**Mortgage Servicing Rights**

The proposed rule would set the risk-weight at 250 percent for mortgage servicing assets (MSAs). We believe this is an excessive risk-weight relative to the actual risk presented by the underlying assets. MSAs are fairly liquid and gain value as rates rise. MSAs give credit unions opportunity to gain income and help manage interest rate risk. Also, credit unions do a great job servicing loans and want to continue to serve members. Many credit unions originate loans and then sell those loans to reduce interest rate and liquidity risk, yet retain the servicing due to the relationship with the member and because these are valuable assets. This arbitrary risk-weight provides a disincentive to retain those servicing rights. We recommend that the risk weight for mortgage servicing assets be reduced to 150 percent.

**CUSO Investments**

The Summit owns a CUSO called Credit Union Auto Finance (or CUAF), which provides underwriting services for indirect lending to a group of credit unions in Western New York. This long established CUSO has a long history of profitable and low risk operations. The 250 percent risk-weight for investments in CUSOs is arbitrary and doesn't reflect the actual risk of investing in most CUSOs. Many CUSOs, including ours, provide services not only to members but also to other (often smaller) credit unions. The risk weightings may cause credit unions operating these CUSOs to close the CUSO and do the service in house only for themselves, hurting the ability of the smaller credit unions to offer the service. We therefore recommend that investments in CUSOs should be assigned a risk-weight of 100 percent to align it with loans to a CUSO and more accurately reflect the risk involved with investing in a CUSO. The total amount of credit union assets that are invested in CUSOs don't represent a systemic risk that could take down the share insurance fund, but this proposed rule could force credit unions to reconsider investments in CUSOs now and in the future. Any exceptions to potential credit union risk should be managed through the examination and supervision process and not by a system-wide "One Size Fits All" approach. We recommend that CUSO investments should be weighted at 100 percent, and any CUSOs that represent an unacceptable level of risk should be managed through the examination and supervision process.

**Examiner Discretion**

The proposed rule provides NCUA the ability to require a higher minimum risk-based capital ratio for an individual credit union in any case where NCUA determines that the circumstances warrant such an action. We have serious concerns that this could undermine the stated purpose of the rule. The current proposal is designed to factor in a number of different risks including interest rate and concentration risk. If the risk-based capital ratios laid out in the proposal do not result in the numbers NCUA examiners would like to see, NCUA can change the rules for an individual credit union. This would make it impossible for us to make sound business decisions concerning its portfolio makeup, not knowing what impact they will have on risk based capital requirements at the next exam. This causes even more uncertainty for credit unions and credit union members, as well as increasing the potential for exam conflict. The NCUA examiners already have many tools, including reporting examiner findings to the Board of Directors of the credit union, requiring Letters of Understanding and Agreement, etc. on specific credit union actions the examiner believes results in unacceptable levels of risk. All these existing tools are meaningful, fully discretionary, and effective. Trying to include a discretionary component to the risk based capital rule is a mistake that will only lead to more litigation and divisiveness between credit unions and the regulator. Ratios and calculations of risk based capitals should be manageable, predictable, and NOT discretionary to that credit unions can effectively manage their balance sheets properly and fairly throughout the industry.

**Time Line for Implementation**

We believe that the proposed 18-month implementation timetable is not long enough for a rule as complex and impactful as this proposed rule. The proposed revisions to net-worth and capital requirements will vastly affect our decision making and it will take time to adjust our balance sheet to align with any new regulation. We will have to either divest assets that are more heavily risk weighted or generate more retained earnings. It is difficult to generate retained earnings in a short period of time when we are being forced to divest the assets that have the largest returns and produce the most retained earnings. We would therefore recommend a 36 month implementation period.

Thank you for your time and attention to the comments submitted on this industry changing proposed regulation. If you need to discuss any of the comments in this letter, please contact Michael Vadala at (585)453-7088 or at vadala@summitfcu.org

Sincerely yours,

Michael S. Vadala
President and CEO