CORNING CREDIT UNION

Gary A. Grinnell, President and Chief Executive Officer

May 21, 2014

Mr. Gerard Poliquin
Secretary to the NCUA Board
1775 Duke Street
Alexandria, VA 22314

Re: Risk Based Capital Proposal

Dear Mr. Poliquin:

On behalf of the Board and Management of Corning Federal Credit Union, I would like to take this opportunity to comment on the National Credit Union Administration's proposed risk-based capital rule approved by the NCUA Board in January 2014.

By way of background, Corning Federal Credit Union is a $1.1 billion asset institution, serving more than 88,000 members. We are well capitalized with a net worth ratio of 8.93%, and we would remain well capitalized with a risk-based capital ratio of 11.67% under the proposed model (as of March 31, 2014). Our delinquency and net charge-off ratios have averaged 0.22% and 0.13%, respectively, over the past five years.

While our credit union recognizes the need for a balanced and credit union-specific set of risk-based capital standards, we believe that in its current form, the proposed rule would have a major negative impact on federally insured credit unions and the value of the credit union charter if substantial changes are not made. To that end, we would like to respectfully address the following concerns and offer some suggested improvements to the proposed regulation in these specific areas.

Overview

We firmly believe that the inclusion of a risk-based capital standard is easily the most important issue to affect the credit union industry this decade. It is truly a legacy-building issue for this NCUA administration, and it will be viewed as either positive or negative depending upon its long-term results within the industry. As such, an issue of this magnitude with the potential for such far-reaching impact deserves an adequate period of time for proper consideration and discussion. Therefore, we encourage NCUA to take its time in finalizing this proposal and to provide the industry ample time to fully participate in the regulatory process. A second comment period after any revisions are made in response to this initial comment period is certainly warranted based upon the interest in and impact of this regulation.

As it is written today, we believe the proposed risk-based capital rule will have a very negative effect on our credit union and the industry as a whole. The potential impact for us and our members is tremendous. In fact, CUNA has estimated that the current proposal will reduce capital buffers in the credit union industry by approximately $7.3 billion. If enacted as proposed, we are convinced this rule will immediately begin to stifle credit union growth, causing credit unions to slow their investments in branches and new technology and will result in increased rates and fees in an attempt to make up this lost capital.

Credit unions have faced many significant challenges over the past ten years that have severely limited their growth options. These include, but are not limited to: further restrictions and increased regulatory scrutiny on their fields of membership, the elimination of RegFlex, and continued economic challenges. In our view, the implementation of this risk-based capital rule will only serve to continue weakening the credit union charter. We believe that large, strong, growth-oriented credit unions will be forced into a serious evaluation of alternative charter options if the proposal is approved as written, even though they would rather remain credit unions.

We also believe there are inherent issues with the current proposal. Our reading of the proposal leads us to conclude that NCUA is primarily reacting to the current systemic risks (interest rate risk and concentration risk). There is little in the proposal that addresses liquidity, credit, operational, or market risks. We are hard pressed to see how such an approach truly measures risk and appropriately focuses upon NCUA's seven pillars as outlined in its 2002 Letter to Credit Unions on the subject. We firmly believe that any risk-based capital proposal must be balanced and should address all future risks in order to adequately protect against more than just current economic conditions.

In our view, the best way to measure whether a credit union is effectively managing risk is to look at its historical performance – a figure available through the call report data being utilized by NCUA for this formula. Any capital or net worth system that does not consider the historical performance of the financial institution in effective asset-liability risk management misses the mark and will restrict the very growth in reserves it is designed to foster through increased earnings.

To that end, we believe NCUA should seriously consider providing additional authorities to those credit unions that are classified as well-capitalized under both ratios (for example: blanket waivers, fixed asset exceptions, personal guarantee waiver authority, and/or longer exam cycles). The inclusion of these additional authorities and others like it would provide a positive incentive for credit unions and would help strike an appropriate balance.

We also believe substantial changes are necessary on the following topics.

Individual Minimum Capital Requirement – Examiner Discretion

Under this proposal, an examiner can increase (we note here that the proposal specifies he or she cannot decrease, only increase) a credit union's individual risk-based capital requirement by subjective action during an examination based upon his or her determination of the need for additional capital versus the balance sheet risk.

In other words, the potential exists where a credit union with 10.5% net worth under PCA and a 15.7% risk-based capital ratio could find itself in non-compliance. As currently proposed, the examiner in this scenario could make an individual determination that the credit union actually needs 16.9% risk-based capital. The opportunity for this regulation to be imposed in an arbitrary and capricious manner must be removed from the final rule.

This provision effectively presents a lack of management clarity that makes it totally impossible for a credit union to strategically manage for compliance under this rule. We believe that this provision serves to actually undermine the effectiveness of the entire regulation as, if the examiner can set his or her own risk-based capital ratio requirement on a credit union by credit union basis, there would seem to be no real reason for a regulation establishing a formula of risk weights to which a credit union should manage. As such, we strongly disagree with any inclusion of an examiner discretion clause and we strongly recommend removing this section in its entirety from the final rule.

CUSOs

We believe that the 250% risk weight for CUSO investments is an arbitrary percentage which does not reflect the actual risk of these types of investments. This risk weight seems artificially high to us and runs the risk of discouraging the risk-sharing and cost-saving collaborative model that CUSOs have become over the past several decades. The overwhelming majority of CUSOs are performing exceedingly well; generating considerable savings through economies of scale and providing much needed non-interest income to their credit union owners.

If the proposal is implemented with a 250% CUSO risk weight, we are concerned that it will have a chilling effect on industry collaboration. The risk weight is also calculated on the current value of the investment, which will only serve to penalize future growth in the very investments that have proven themselves to be successful. This all seems counter to the credit union cooperative model and philosophy, not to mention contrary to the stated purpose of this proposed rule that less risky investments should be encouraged and more risky ones discouraged through the required capital retention associated with each.

We recommend changing the 250% risk weight to 100% because CUSOs have largely been successful and individual exceptions can be managed through the examination and supervision process established under the recently enacted CUSO Rule.

Investments

Credit unions already control for interest rate risk through their own policies and monitoring, as well as through the NCUA examination process. The proposed rule does not factor in these controls or the credit quality of the investments. We believe that any final rule must take these into consideration. In addition, because the proposal focuses only on length of investment and not quality, some credit unions may consider higher risk short-term investments in order to maximize their return. We believe the investment type and term must be balanced when determining the risk weighting.

We recommend an alternative risk weight system for investments that is tiered with percentages that are a more accurate reflection of risk. For example, the risk weight of 0-5 year investments could be 20%, with those at 5-10 years weighted at 100% and investments greater than 10 years perhaps at 125% or 150% - although we fail to see why any investment should be weighted above 100%.

Real Estate Loans

Under the current proposal, non-delinquent first and second mortgage real estate loans are weighted solely on concentration risk, not credit risk. This rationale is flawed because there is no mitigating factor for adjustable rate mortgages, loan-to-value ratios, credit rating, or performance of the loans. Furthermore, we believe the risk weights assigned to each concentration tier are too high and penalize credit unions for higher concentration of loans that are not inherently risky.

We recommend reducing the number of concentration risk buckets from 3 to 2 and introducing larger ranges of asset concentrations. We also believe credit risk should be incorporated into the rule and credit unions should receive credit for performing loans. For example, credit unions could receive a 50 basis point reduction in each concentration risk category if the credit union's charge-off ratio is below 1.5% over a five-year average.

Mortgage Servicing Assets

Although we understand that there is some additional risk exposure for credit unions in the area of mortgage servicing rights, it is our belief that the proposed risk weighting of 2.50 is disproportionate to the risk. The current proposed 250% risk weight for mortgage servicing is unnecessarily high and if not modified will serve to discourage risk management through the secondary market and loan participations. The risk weight also fails to recognize that there are two accounting methods for mortgage servicing (fair value and amortization). Clearly, these methods should not be treated with the same risk weight because the amortization method is inherently more conservative.

We recommend adding a question to the call report which asks which accounting method is being used for mortgage servicing. Credit unions using the amortization method should be assigned a risk weight of 100% and credit unions using the fair value method should be at 150%. Doing so would encourage credit unions to use a more conservative accounting treatment and would mitigate risk.

Member Business Loans (MBLs)

The proposed rule does not give any credit to organizations with proven minimal losses in business lending. There is no consideration for delinquency, length of experience, loan performance, personal guarantee, or credit rating. We believe that any final rule should give credit for strong member business loan portfolios that incorporate all of these considerations, not just concentration risk.

In addition, we believe that credit unions originally chartered for the purpose of making business loans are exempted from the statutory member business lending cap of 12.25% of assets and should be exempted from this portion of the rule. Credit unions historically chartered for the purpose of making business loans, a category clearly recognized by law and designated in the NCUA database from which the risk weighted numbers are drawn, should be exempted from the concentration-based increased weights and their entire business loan portfolio weighted at 1.0. We urge the NCUA Board to include such an exemption from the concentration weight increases for this special class of credit unions.

Also, we ask that incentives in the form of increased flexibility be added to the proposed system to encourage responsible business lending. For example, NCUA should consider providing a credit of 50 basis points in every category of business loan concentration if the credit union has had less than 1.5% of charge-offs in its business and/or mortgage loan portfolio as an average over the past three years and well-capitalized credit unions could also be granted waiver authorities such as waiving the personal guarantee.

Implementation Period

Commercial banks have until December 2019 to comply with Basel III risk-based requirements, which comes after a three-year phase in period. NCUA's current 18-month implementation time table is unreasonable, too arbitrarily aggressive, and does not allow nearly enough time for credit unions to adjust their balance sheets to comply with the new rule.

We recommend a minimum three-year implementation period beginning from the date a final rule is adopted. This will give credit unions sufficient time to raise capital through retained earnings. Also, as referenced earlier, we respectfully request an additional comment period following any changes to the proposed rule.

Supplemental Capital

We believe NCUA missed a valuable opportunity to include supplemental capital in this proposal. In light of the restrictions brought on by the proposed rule, we believe supplemental capital authority is needed now more than ever to keep the credit union industry strong and sustainable for decades to come.

We recommend that NCUA include a supplemental capital provision into the regulation. Supplemental capital from subordinated debt can be included in a credit union's risk-based capital ratio even though we recognize that it cannot count toward the statutory net worth ratio. Allowing credit unions to count subordinated debt in their risk-based capital ratio would be a very positive change while not changing the fundamental way capital is counted as net worth toward the statutory PCA ratio.

Comparison to BASEL III

We recognize that NCUA's risk based capital proposal is required to be equivalent to the banking industry's BASEL III. To that end, we have compared our risk-based capital ratio with the BASEL III calculations and as of December 31, 2013, our risk-based capital ratio under

NCUA's risk-based capital proposal was 11.38%. In comparison, our ratio would increase to 13.71% under BASEL III. This represents an immediate 20% increase to our ratio and demonstrates that we would have a far better capital ratio if we were a for-profit bank. Clearly, when a credit union would be considered better capitalized if it were a bank, there are fundamental flaws in this formula and significant changes should be made to NCUA's proposal.

In addition, there are other key differences between NCUA's proposal and BASEL III. Based on our understanding of BASEL III, it does not include any provisions for concentration risk whereas NCUA's proposal seems to be overly based upon concentration risk categories. The weights themselves are also much higher under NCUA's proposal than BASEL III. For example, in BASEL III, residential mortgages are weighted at 50% regardless of concentration. NCUA's proposal weights them at 100% for credit unions with concentrations of 35% or more of assets. As an additional example, small business loans are weighted at 100% regardless of concentration under BASEL III, but they can be weighted as high as 200% for credit unions with concentrations of 25% or more of assets.

If NCUA's final rule is to be comparable to BASEL III, we would expect our risk-based capital ratio to be much more closely proximate to the community bank BASEL standards than in this proposal.

Conclusion

Thank you for the opportunity to comment on this proposed regulation. We strongly support NCUA's efforts to pursue a balanced risk-based capital system; however, we believe that significant changes to the proposed rule are necessary and required. We respectfully encourage NCUA to consider the recommended improvements to the proposal contained herein and provide credit unions with a second comment period before implementing a revised and final rule.

Should you have any questions or require additional information in support of the recommendations made herein, please feel free to contact me at 607-962-3144, ext. 292.

Sincerely,

Gary A. Grinnell
President and Chief Executive Officer

cc: The Honorable Debbie Matz, Board Chairman
The Honorable Michael Fryzel, Board Member
The Honorable Rick Metsger, Board Member
The Honorable Charles Schumer, United States Senate
The Honorable Kirsten Gillibrand, United States Senate
The Honorable Tom Reed, United States House of Representatives