CHARTWAY
FEDERAL CREDIT UNION

April 15, 2015

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

Dear Mr. Poliquin

On behalf of Chartway Federal Credit Union's (CFCU) Board of Directors and its membership, we would like to express our appreciation for the opportunity to once again comment on the proposed Risk-Based Capital (RBC) regulations issued by the Board of the National Credit Union Administration (NCUA).

As affirmed in prior RBC-related communications, we agree that an updated Risk-Based Capital regulation is essential. We remain supportive of the overall RBC objective in improving the quality of capital and additionally recognize many incremental improvements in this revised proposal, however, we strongly urge the agency to reexamine the treatment of goodwill for credit unions that acquired insolvent credit unions without assistance from the NCUSIF in a period prior to the implementation of new risk based capital rules.

We firmly believe the proposal as written would place all credit unions that acquired (under supervisory / emergency merger conditions) failing or insolvent credit unions at a competitive disadvantage - including those, like ours, where NCUA, the NCUSIF and the credit union industry realized benefit from these acquisition activities.

Background

You may recall that several years ago, CFCU acquired three failing credit unions: HeritageWest, SouthWest Community, and Utah Central Credit Unions.

When considering these acquisitions, as an integral part of our due diligence we thoroughly studied the impact these emergency mergers would have on our capital classifications and our ability to meet the regulatory measurement of "adequate / well capitalized" for risk-based net worth (RBNW). When we were able to conclude that acquiring these failed credit unions would be mutually beneficial to CFCU and NCUA, we agreed to pursue these partnerships. CFCU would be provided a platform for growth without requesting assistance from NCUA, nor compromising our strong capital position. In turn, the NCUSIF and industry as a whole would be saved approximately $37 million. Additionally, we understand that the current accounting treatment of goodwill in accordance with GAAP has also saved the NCUSIF millions of dollars: approximately $750 million industry-wide.

Now, the NCUA is moving to change the rules "in the middle of the ballgame" – which will drastically impact credit unions like CFCU. Under the proposed rule, we would be required to adjust our future strategy and positioning that is currently focused on growth, member service and community reinvestment opportunities. Additionally, we would risk a drop in status from "well-capitalized" to "under-capitalized." We believe other credit unions will face the same fate, ultimately creating additional exposure to the NCUSIF.

Notably the ten year deferral of goodwill as proposed is a good and equitable solution for those credit unions that acquired failed credit unions and received some level of funded assistance from the NCUA / NCUSIF as the amount of goodwill carried on their books would typically be less than goodwill carried by those credit unions that did not receive assistance. This is because the funded amount of assistance from the NCUSIF upon receipt by the continuing credit union is recorded as a reduction to the goodwill determined at the time the failed credit union is acquired.

For example, if goodwill at the time of acquisition is determined to be $71M and NCUA subsequently provides $37M in NCUSIF assistance, the goodwill on the books of the acquiring credit union will be recorded and carried at $34M (the $71M goodwill less the $37M in NCUSIF assistance). As a result, the impact to the proposed RBC equity ratio for those credit unions that received NCUSIF assistance would be significantly less since the RBC calculation would reduce equity (the numerator) by only $34M as compared to the $71M for those credit unions that did not receive assistance but correspondingly reduced losses to the NCUSIF fund.

Please understand, CFCU did not waive a request for NCUSIF assistance because the failing credit unions we acquired provided any additional benefit to CFCU as compared to those where NCUSIF assistance was provided to other credit unions (see attachment B). Instead we approached these mergers with the primary objective of utilizing the regulatory rules in place in 2010 / 2011 to acquire and at the same time provide relief to the fund and industry in that most turbulent and extraordinary economic period. Had the RBC proposed rules been in effect at that time – CFCU would not have been able to offer or provide that same savings to the NCUSIF.

Now consider the impact to CFCU: while our competitors (for the next ten years) would have the opportunity to focus on survival, service, product innovation, community reinvestment and growth in this highly competitive financial services market, credit unions like CFCU would be forced to forgo these same opportunities in lieu of having to meet changed regulatory risk based capital targets. Is it right to be penalized for reducing losses to the NCUSIF by not having sought funding support from the NCUSIF under a previous set of rules?

That said, we believe we have developed an equitable RBC treatment of Goodwill that will limit any additional exposure to the NCUSIF today and more importantly, prevent and actually reduce risk to the fund in the future.

Recommendations

It is important that the final RBC ruling does not create a disadvantage to credit unions like ours that mitigated financial exposure to the NCUSIF and industry through unassisted acquisitions of failed credit unions. While we appreciate the proposed 10-year goodwill deferral that provides some temporary relief, we strongly urge the agency to consider granting a one-time permanent exemption of goodwill to credit unions like CFCU that made significant, capital-impacting decisions under a very different set of regulatory risk based capital rules.

To return to the analogy noted above, is it right to “begin playing a ballgame” under one set of rules and then change the rules “in the seventh inning.”

The manner in which we propose the exclusion of goodwill transactions recorded prior to the implementation date of the revised RBC proposal first considers the new NCUA term and definitions (page 125 of the revised RBC proposal) of a Supervisory Merger or Combination transaction outlined in the proposal as follows:

1. An assisted merger or purchase and assumption where funds from the NCUSIF are / were provided to the continuing credit union

2. A merger or purchase and assumption classified by NCUA as an "emergency merger" where the acquired credit union is either insolvent or "in danger of insolvency" as defined under appendix B to part 701

3. A merger or purchase and assumption that included NCUA's or the appropriate state officials identification and selection of the continuing credit union

In complying with the NCUA terms and definitions as currently proposed, the one-time permanent exclusion of recorded GAAP goodwill is recommended as follows:

Recommendation — *Qualifying under the NCUA definitions whereby NCUA / NCUSIF funded assistance was not provided to the continuing credit union – GAAP compliant goodwill would be granted a one-time permanent exclusion (as a deduction) from the RBC Equity calculation (the numerator). In accordance:*

a. *The excluded goodwill (as defined by NCUA – page 93) must have originated from a supervisory merger or combination that was completed no more than 29 days after publication of this rule (Federal Register)*

b. *The excluded goodwill would be classified as "Other Assets" in the determination of risk based assets (the denominator) with a reasonably applied risk factor in the range of 100 to 250 percent.*

c. *Credit unions qualifying for the excluded goodwill would be required to maintain and document the performance of an annual independent Test of Goodwill Impairment in accordance with GAAP (see attachment C).*

We understand NCUA's concern regarding the ability of financial institutions to realize the value of goodwill in adverse economic conditions, but we believe our recommendation addresses this concern and clearly limits, eliminates, and actually reduces future exposure to the NCUSIF considering:

1. No additional goodwill can be excluded going forward as the exclusion is only applicable to GAAP goodwill recorded prior to the implementation of the proposed RBC ruling, therefore, the amount of excluded goodwill is “locked” and cannot (in any way) increase exposure to the NCUSIF in the future.

2. Future impact and exposure to the NCUSIF actually decreases as the level of credit union RBC GAAP and regulatory equity grows over time while the amount of excluded goodwill remains constant. As a result, the one-time excluded goodwill as a percent of RBC equity is reduced over time along with the related exposure to the NCUSIF as is evident with CFCU actual year-end 2014 position along with projected growth in equity as follows:

		GAAP Goodwill	GAAP Equity	GW to GAAP Equity %	Regulatory Equity	GW to Regulatory Equity %
2014	Year End	$ 71,488	$ 156,077	45.8 %	$ 150,550	47.5 %
2015	Year End	$ 71,488	$ 163,000	43.7 %	$ 158,000	45.3 %
2020	Year End	$ 71,488	$ 206,000	34.7 %	$ 201,000	35.6 %
2025	Year End	$ 71,488	$ 260,000	27.5 %	$ 255,000	28.0 %

Note: Growth in both GAAP and Regulatory Equity was estimated using a net spread of thirty-five basis points on average assets that are projected to grow at a compounded annual rate of five percent.

The entire industry would trend in this same manner, again, significantly reducing the exposure to the NCUSIF in the future (again, grandfathered goodwill cannot grow while capital continues to accumulate).

3. The exclusion of this goodwill from the RBC equity calculation would then warrant inclusion in the risk asset calculation and with a reasonable risk factor of 100 to 250 percent, this will provide an additional regulatory “cushion” to the fund going forward.

4. By requiring an annual independent Test of Goodwill Impairment in adherence with GAAP, the recorded value of goodwill is further validated and accordingly would not result in losses to the NCUSIF in the unlikely event the continuing credit union were to be liquidated (see Attachment C).

While the 100 percent exclusion of goodwill for the credit unions qualifying is both justified and recommended in order to maintain consistency with the original “rules of the ballgame”, the ongoing conservative concerns of NCUA related to the value of goodwill in times of adversity is understood.

All things considered, a compromise for discussion that would "partially" protect those credit unions that contributed to a reduction in losses to the NCUSIF and the regulator in reducing even further the impact of goodwill recorded prior to the implementation of the RBC proposal, please consider the following:

In complying with the NCUA terms and definitions as currently proposed, and utilizing the distinct components of goodwill (see Attachment A) associated with future revenue / capital accumulation opportunities available to the continuing versus asset / liability market valuations related to liquidation value, partial exclusion of recorded GAAP goodwill is submitted for discussion:

Recommended Partial Exclusion	*Qualifying under the definition of a merger or combination transaction whereby NCUA assistance was not provided to the continuing credit union – a portion of GAAP compliant goodwill would be granted a one-time permanent exclusion (as a deduction) from the RBC Equity calculation (the numerator). In accordance:*

a. *The portion of excluded goodwill (as defined by NCUA – page 93) must have originated from a supervisory merger or combination that was completed no more than 29 days after publication of this rule (Federal Register)*

b. *The portion of excluded goodwill associated with the marked value of assets and liabilities versus the future revenue / capital accumulation opportunities available to the continuing credit union (see Attachment A) would be determined utilizing the independent third party valuation report effective at the date of acquisition (as defined in the Statement of Standards for Valuation Services of the American Institute of Certified Public Accountants).*

c. *The portion of excluded goodwill would be classified as "Other Assets" in the determination of risk based assets with a 100 percent risk factor applied.*

d. *Credit unions qualifying for any portion of excluded goodwill would be required to maintain and document the performance of an annual independent Test of Goodwill Impairment in accordance with GAAP.*

The above recommendation and compromise solution for discussion further protects the NCUSIF fund in reducing current amounts of recorded goodwill (as a percent of the NCUSIF) and eliminates any additional exposure related to GAAP goodwill recorded prior to the implementation of the proposed RBC regulation. Additionally, in merging these failing credit unions we feel that it was in the spirit of partnership with NCUA that protected the NCUSIF from increased losses and exposure during those unique economic times and would simply ask that a certain level of regulatory relief be afforded based on the regulatory rules in effect at that time.

Conclusion

Developing risk-based capital requirements for credit unions is a necessary and undeniably complicated endeavor. Given that the proposal will have a tremendous impact on credit unions like ours – jeopardizing not only our capital position but ultimately our ability to execute a member-focused strategy - we urge the agency to incorporate our recommendations pertaining to the grandfathering of credit unions that made capital-impacting decisions based on the rules at the time and reissue a new proposal.

The Chartway family of credit unions remains committed to working with NCUA and the industry at-large to establish a regulation that improves capital standards without unduly and unfairly burdening the credit union industry and its members.

Thank you again for the opportunity to comment on this vital issue. Should you have any questions regarding this correspondence, please don't hesitate to contact me.

Sincerely,

Ronald L. Burniske
Chief Executive Officer

ATTACHMENT A

COMPONENTS OF GOODWILL

The components of goodwill as reflected in the independent third party valuation results as prepared and reported by Wilary and Winn Risk Management, LLC (see below Schedule 1) at the date of each acquisition are outlined below and reflect two distinct segments:

- Those comprising a projected Return on Average Assets (ROAA), the Projected Income and Market Valuation all creating the ability of the continuing credit union to accumulate capital through revenue earned in future years, and

- Those comprising the market value of the financial and non-financial assets and liabilities of the failed institution that create no value in earnings or capital to the continuing credit union but essentially reflecting the marked value in the event of liquidation.

For CFCU, the goodwill components at acquisition of HeritageWest FCU (HW), SouthWest Community FCU (SW) and Utah Central (UCCU) were as follows:

Goodwill Components (in thousands)

	HW	SW	UCCU	Total
ROAA Projected	$ 2,585	$ 0,770	$ 00	$ 3,355
Income Projected	10,892	2,087	00	12,979
Market Valuation	0,307	0,534	00	0,841
Subtotal – Future Value	$ 13,784	$ 3.391	$ 00	$ 17,175
Value of Financial Asset/Liabilities	$ 34,245	$ 19,900	$ 33,037	$ 87,182
Value – Non-Financial Asset/Liabilities	(8,208)	(10,504)	(11,830)	(30,542)
Value Core Deposits (CDI)	(0,956)	(0,810)	(0,561)	(2,327)
Subtotal Marked A & L	$ 25,081	$ 8,586	$ 20,646	$ 54,313
Total Goodwill	$ 38,865	$ 11,977	$ 20,646	$ 71,488

Segmenting the above components in a manner that more clearly reflects the goodwill segment that provides future benefit to the continuing credit union in revenues or capital accumulation (including any GAAP Equity received at the time of acquisition) compared to that portion of goodwill associated with the marked, if liquidated, value of assets and liabilities is as follows:

Attachment A - continued

In thousands

	HW	SW	UCCU	Total
Add: Future Revenue / Capital	$ 13,784	$ 3,391	$ 00	$ 17,175
Add: GAAP Equity	17,176	00	00	17,176
Current & Future Value	$ 30,960	$ 3,391	$ 00	$ 34,351
Less: Total Goodwill	(38,865)	(11,977)	(20,646)	(71,488)
NCUSIF Assistance - Waived	$ (7,905)	$ (8,586)	$ (20,646)	$ (37,137)

If RBC, as proposed, was in effect at the time of these acquisitions, CFCU would have requested assistance amounting to an estimated $37 million from the NCUSIF to offset the impact to RBC equity and ratios under the RBC regulation – specifically correlating to the segment of goodwill attributed to the marked assets / liabilities in acquiring the three failed credit unions. Notably, this was most likely the basis for much of the NCUSIF funded assistance that was disbursed to credit unions acquiring insolvent credit unions during that time.

That savings to the NCUSIF from the CFCU acquisitions would not have been possible if the proposed RBC were in place at that time. Unless assistance had been provided, our RBC ratio would have fallen as low as 4.45 percent in 2011 upon acquisition of our third failed credit union. Most likely, this would have resulted in a NCUA bidder's package / process to ensue with resulting losses to the NCUSIF significantly greater.

SCHEDULE 1

Wilary Winn Risk Management LLC

Founded in 2005, Wilary Winn Risk Management LLC provides independent, fee-based, financial advice to more than 375 financial institutions located across the country. Its clients include 26 of the top 100 credit unions and 43 publicly traded banks. WW Risk Management's services include:

- Estimation of Fair Value.
- Asset Liability Management Advice.
- Valuation of Illiquid Financial Instruments.

Estimation of Fair Value:
WW Risk Management is one of the country's leading providers of fair value advice – services include:

- Mergers and Acquisitions Accounting – the company has advised on more than 150 credit union mergers since January 2009, when the purchase accounting rules became effective. To support its work, it developed an accounting white paper on the *Accounting for Credit Union Mergers* and companion FAQ (available on its website).
- Goodwill Impairment Testing - including quantitative and qualitative testing.
- Accounting for Loans Purchased with Deteriorated Credit Quality (ASC 310-30).
- Troubled Debt Restructurings.
- Fair Value Footnotes.

WW Risk Management is a nationally recognized expert on fair value accounting and regulatory reporting and has led seminars on the subject for many of the nation's largest accounting firms, the NCUA, the FDIC and the AICPA. In addition, it has developed an accounting and regulatory guide for Federal Home Loan Banks Mortgage Partnership Finance (MPF®) program now in its seventh printing.

Asset Liability Management Services:
In addition, the firm offers a complete suite of ALM advice and services:

- Ongoing ALM measurement and advice.
- ALM Model Validation.
- Core Deposit Sensitivity Analysis.

Illiquid Financial Instruments Services:
WW Risk Management also values illiquid financial instruments including:

- Mortgage Servicing Rights Portfolios – the company values more than 175 portfolios, at least annually, ranging in size from $5 million to over $5 billion and totaling over $35 billion.

- Mortgage Banking Derivatives - including interest rate lock commitments (IRLCs) and forward loan sales commitments.
- Non-Agency MBS – the company values more than 400 CUSIPs quarterly.

Contact Information

For more information about Wilary Winn Risk Management's services, please contact one of the following individuals.

- Mergers and Acquisitions, Goodwill Impairment Testing, ASC 310-30 Accounting, TDRs, and Fair Value Footnotes:
    - Brenda Lidke blidke@wilwinn.com

- Asset Liability Management and Private Label MBS/CMOs:
    - Frank Wilary fwilary@wilwinn.com

- Mortgage Servicing Rights and Mortgage Banking Derivatives:
    - Eric Nokken enokken@wilwinn.com

ATTACHMENT B

OIG – MATERIAL LOSS REVIEWS

The Office of Inspector General provides a report of Material Loss Reviews for failed credit unions with assistance over the period of our acquisitions. A few examples are as follows:

High Desert FCU (Alaska–P&A)	06/18/09	Assets	$ 102m	Cost NCUSIF	$ (24m)
ClearStar CU (United-P&A)	09/25/09	Assets	$ 144m	Cost NCUSIF	$ (12m)
Ensign FCU (EDS-P&A)	11/13/09	Assets	$ 98m	Cost NCUSIF	$ (30m)
Certified FCU (Vons Emp FCU)	07/31/10	Assets	$ 50m	Cost NCUSIF	$ (10m)
Beehive CU (SSFCU- P&A)	12/14/10	Assets	$ 152m	Cost NCUSIF	$ (25m)

Alternatively, the cost to the NCUSIF and credit union industry as a result of the three CFCU acquisitions is as follows:

HeritageWest (CFCU- P&A)	12/31/09	Assets	$ 311m	Cost NCUSIF	$ 00m
SW Community (CFCU-P&A)	06/30/10	Assets	$ 139m	Cost NCUSIF	$ 00m
Utah Central CU (CFCU-P&A)	04/30/11	Assets	$ 137m	Cost NCUSIF	$ 00m

ATTACHMENT C

TEST OF GOODWILL IMPAIRMENT

In order to mitigate such uncertainty, we propose the following:

1. Require credit unions that would qualify for the exclusion of all or a portion of goodwill as recommended to provide additional protection to the fund by performance of an independent Test of Goodwill Impairment in strict accordance with Statement of Standards for Valuation Services (SSVS) of the American Institute of Certified Public Accountants (AICPA) on an annual basis. This test validates the reported balance in goodwill and provides a level of certainty that in the unlikely event that CFCU were to be liquidated, the market value would "cover" any impact or loss exposure from the goodwill asset balance as recorded on the books of the credit union. The following summarizes the requirements of GAAP the credit union follows with the results of the independent Test of Goodwill Impairment:

    a. Goodwill Impaired: the tested value of goodwill is less than the recorded book value The credit union, per GAAP, is required to write down the balance of goodwill by the amount reported as impaired through the Income Statement thereby reducing both the Regulatory and RBC capital position. This essentially achieves the objective of the RBC proposal (whether deferred or not) in reducing the Net Worth of the credit union by an amount equal to the value of the assets upon liquidation.

    b. Goodwill not Impaired: the tested value of goodwill is greater than the recorded book value If the tested value of goodwill reported exceeds book value, no adjustment per GAAP is recorded by the credit union thereby maintaining an even more conservative goodwill position relative to the value of credit union assets in the event of liquidation (virtually no exposure to the share insurance fund). Since required annually, this would additionally ensure that the proper valuation of the goodwill asset is performed in both favorable and unfavorable conditions whether caused internally by poor management decisions or externally as a result of sponsor issues or economic conditions.

Accordingly, the independent Test of Goodwill Impairment and correlating entry (if goodwill results reflect an impairment) maintained in accordance with GAAP would therefore justify both the value of goodwill represented on the Balance Sheet and bring a level of certainty in achieving the objective of the RBC proposal without the need to reduce the RBC Net Worth numerator.

Sincerely,

Ronald Burniske
Chief Executive Officer