summit
CREDIT UNION

April 24, 2015

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

RE: Risk-based Capital

Dear Mr. Poliquin:

Summit Credit Union is a Wisconsin chartered credit union, headquartered in Madison, Wisconsin. Summit serves more than 140,000 members and holds more than $2 billion in total assets. This letter includes our comments on NCUA's proposed changes to the credit union risk-based capital system, as published in the Federal Register in January 2015.

Summit believes the revised proposal is significantly improved relative to the previous proposal. In particular, we support the new definition of commercial loans and the removal of weighted average lives as a determinant of investment risk weights. This letter will focus on changes we believe would further strengthen the regulation.

RISK WEIGHTS

- The proposed risk weights for second mortgages are unreasonably high, being set at the same level as unsecured loans. While, as NCUA points out, chargeoff ratios are higher for second mortgages than for first mortgages, it is also the case that chargeoff ratios on second mortgages are much lower than chargeoff ratios on credit cards and personal loans. In the last five years, loss ratios on second mortgages were less than one-half the losses on credit cards. The appropriate risk weight for second mortgages would be 75%, the same as consumer loans secured by personal property. If an additional risk weight is required for higher concentrations of second mortgages, the weight on those loans should be 100%, rather than the 150% in the current proposal (which is the weight used for non-current loans of several types).

  In discussing the proposed treatment of real estate loans, NCUA cites three Material Loss Reviews of failed credit unions. These reviews do not support the case for residential second mortgages being treated as having especially high risk:

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(1) The Review of Ensign Federal Credit Union hardly mentions second mortgages. Its discussion of Ensign's failure emphasizes construction and development loans and other business loans, ineffective collections, poor control of operating expenses, and liquidity management problems.

(2) The Review of Beehive Credit Union states "...Beehive's main lending products were speculative construction and real estate development (lot) loans."

(3) The Review of Cal State 9 Credit Union describes "weak underwriting standards..." in an "indirect HELOC portfolio..." in which "substantially all of the HELOCs ...had subprime elements." To compound these problems, a single member of senior management oversaw these indirect loans, and received bonuses that created a conflict of interest. This case illustrates the risks of indirect second mortgage loans that were poorly underwritten using subprime standards and poor controls, but does not justify high risk weights on second mortgages in general.

Second mortgages offer great advantages for members, and prudently underwritten second mortgages are safe assets for credit unions to hold. Home equity lines of credit are one the most popular forms of adjustable rate lending, and discouraging credit unions from expanding their home equity lending will inevitably push credit unions into balance sheets with more interest rate risk.

- Risk weights should be reduced for assets in "For the Benefit Of" accounts. Many credit union balance sheets include assets that are technically owned by the credit union, but the risk of losses on those assets is contractually transferred to a beneficiary (typically a management employee). Examples include 457b and certain 457f plan investments. These investments should have a zero risk weight, as they are the economic equivalent of funds contributed to 401k plans and removed from a credit union's balance sheet.
- The proposed risk weight for mortgage servicing rights is excessive at 250 percent. NCUA's discussion of the risks of these assets does not mention credit risk. A weight of 100 percent, comparable to unsecured loans, would be more appropriate as there is no collateral directly supporting the value of the servicing right. One could also argue the weight should be lower than 100 percent, given the servicing rights provide a hedge against rising interest rates.

NUMERATOR FOR RISK-BASED CAPITAL RATIO

- The proposed numerator of the risk-based capital ratio includes a deduction for "identified losses," defined as "those items that have been determined by an evaluation made by NCUA...in accordance with GAAP, to be chargeable against income, equity or valuation allowances..." Because the Credit Union Membership Act requires credit unions larger than $10 million to follow GAAP, there is no need for this deduction. In the event NCUA determines a credit union has not recorded losses according to GAAP, the solution is to require the credit union to restate its financial statements.

- If NCUA believes the risk-based capital regulation needs a deduction for "identified losses," despite the longstanding legal requirement that credit unions must follow GAAP, the definition should be clarified. The proposed definition includes the language "to be chargeable against income, equity or valuation allowances". This should be revised to include only items chargeable against income. The current definition may be interpreted by some as saying the numerator should be reduced by unrealized losses on Available for Sale investments or other elements of Other Comprehensive Income.

DEFINITIONS

- The definitions of "amortized cost" and "exposure amount" do not discuss the treatment of Other Than Temporary Impairments (OTTI). If OTTI has already been recognized in earnings, the credit union should not be required to hold capital against the previously recognized loss.
- In the definition of "commercial loan" there is ambiguity regarding loans to non-profit organizations. Would those loans generally be considered commercial loans? Would the treatment depend on the nature of any collateral securing the loan?
- The definition of "restructured" is unnecessary and problematic. In order to avoid complexity and confusion, it would be preferable to write the regulation using terms already in widespread use and defined by GAAP, such as "Troubled Debt Restructuring (TDR)." If NCUA wishes to carve out special treatment for certain types of restructured loans, it can do so using language such as "All TDRs excluding loans restructured pursuant to the U.S. Treasury's Home Affordable Mortgage Program."
- The definition of "current" should not exclude all restructured loans. If there is any reference to restructured loans, the reference should be to "Troubled Debt Restructurings (TDRs)." This would clarify the definition, and also leave open the possibility that a loan may once again be considered current if it was restructured at some point in the past but no longer meets the GAAP definition of TDR.
- Any time the term "CUSO" is used, the rule should distinguish between those CUSOs that are consolidated in the credit union's financial statements and those that are not, in order to avoid double counting of the assets of consolidated CUSOs.

INTEREST RATE RISK REGULATION

We disagree with NCUA's contention that additional regulation of credit union interest rate risk management is required. Credit unions already have an interest rate risk regulation and a liquidity risk regulation that go beyond banking regulations. In addition, the credit union supervisory process already places a great deal of emphasis on management of these risks.

Rather than imposing new regulations, NCUA can improve its monitoring of credit union interest rate risk, with better use of call report information that is already available and adjustments to ratios NCUA currently publishes.

- NCUA's Net Long Term Assets Ratio is based partly on loan purpose, rather than interest rate risk, in that it includes all business loans. The ratio also uses equal weights for all the included loans and investments, so that an investment with three years remaining maturity is treated the same as a 30-year fixed rate mortgage. Fixed assets and the NCUSIF deposit are included because they earn no interest, but there is no credit for funding sources with zero interest cost.
- NCUA's Supervisory Interest Rate Risk Threshold Ratio treats as identical all first mortgage loans and investments longer than five years, with no weighting based on the asset's term or whether the asset has a fixed versus adjustable interest rate.

CALL REPORT CHANGES

We appreciate that the revised proposal includes a longer period before the rule's implementation date. Given the significant new reporting requirements the rule will bring, credit unions should receive the new Call Report format at least three years before the implementation date. Credit union reporting systems will need to be revised to capture and report new data regarding assets as those assets are acquired. In some cases credit unions will also need to capture and record new data regarding existing assets, which is often a manual and time-consuming process.

We encourage NCUA to form a working group of credit union financial professionals to collaborate on designing a Call Report format to support the final risk-based capital regulation. Our credit union participated in a group that worked with NCUA to improve reporting of TDRs and modified loans, and we would be happy to participate in further changes to the Call Report. The next round of changes can also improve the Call Report process in general, by eliminating unnecessary information and clarifying definitions. The current Call Report format's overlapping schedules and unclear definitions lead to large amounts of examination time being devoted to reviewing how credit unions completed their call reports, and that time could be better used in evaluating risks and risk management.

In conclusion, we appreciate the opportunity to comment on NCUA's revised proposal for changes to the risk-based capital system. We think the revised proposal is much improved relative to the first proposal. We believe these further improvements will result in a more effective final product.

Sincerely,

Keith Peterson
Chief Financial Officer
Summit Credit Union

cc: Kim Sponem, CEO/President