

SchoolsFirst™

FEDERAL CREDIT UNION

April 25, 2010

Ms. Mary Rupp
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

Re: Proposed Rule, Parts 703, 704, 709 and 74
Removal of References to Credit Ratings from NCUA Regulations

Dear Ms. Rupp,

SchoolsFirst Federal Credit Union serves school employees and their families in Southern California. We have more than 475,000 Members and \$8.5 billion in assets. SchoolsFirst FCU is pleased to have the opportunity to comment on NCUA's proposed rule to remove references to credit ratings from NCUA regulations.

While we realize that the implementation of this proposal is required by Section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), we believe that the proposal, as written, will have the unintended consequence of creating confusion and uncertainty for the credit union industry.

Concerns

Credit unions have long relied on the expertise of Nationally Recognized Statistical Rating Organizations (NRSRO's) and their ratings in determining the strength of their investments and thus, the permissibility of said investments. This proposal seeks to abandon reliance on this expert structure and standardized methodology by requiring credit unions to rely solely on internal evaluations and/or seek third-party advice regarding the strength of the issuer of a security. Without uniform supervisory guidance on the indicators that will support a determination that an issue or issuer has the necessary capacity to meet its financial commitments, confusion and conflicts over judgment will lead to counterproductive and costly processes, potentially increasing risk and more burdensome exams.

NCUA states that it will issue guidance at a future date as to how credit unions are expected to apply the proposed narrative structure of the credit ratings in analyzing an investment; in other words, to determine what criteria will satisfy a "very strong," "strong," or "adequate" capacity. We believe that guidance must be issued prior to finalization of the proposal in order for credit unions to have an opportunity to voice any concerns that they might have in advance of being bound to comply with the narrative indicators.

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By requiring credit unions to rely on unique internal evaluations and the guidance of third-party companies, ***non-standardization across the credit union spectrum as well inconsistency will result***. The absolute removal of reliance on NRSRO ratings will signal the beginning of a cottage industry of companies and "advisers" looking to step in to fill the void left by the forced withdrawal of the NRSRO ratings. It is inevitable that credit unions, especially smaller ones, will end up relying on advice of other third-party companies, which will likely have less talent and capacity than Moody's, Fitch's and Standard & Poor's. How is this any different or any better than allowing at least a baseline reliance on NRSRO ratings? While large credit unions may have the necessary resources to vet this plethora of companies and advisers, smaller credit unions likely will not.

This may have the unintended consequence of smaller credit unions relying on misguided advice provided by broker/dealers using their own entity research papers to sell investments to credit unions. Besides the inherent conflict this represents, the research may be limited or flawed, which then has the potential to result in investment losses leading to adverse impacts on exams and ultimately the NCUSIF. Clearly, this would be to the detriment of the membership of those credit unions and to the credit union movement as a whole.

The proposal also requires that for counterparty transactions a credit union's Board set an internal standard for the credit analysis to be conducted by the credit union. Board of Directors in credit unions may not have the financial expertise necessary to establish standards of credit review for such complex transactions, and it could end up being very costly for credit unions to deal with yet another complex regulation.

While NCUA's recent requirement for director financial literacy ensures that directors are able to read a profit and loss statement and a balance sheet, the ability to comprehend the complexities presented by these transactions and to set adequate due diligence standards is beyond the scope of what a volunteer director should be expected to do.

Furthermore, different Boards may have different appetites for risk and, due to the lack of uniform guidance from a standardized source; each Board will make its own determinations. Thus, multiple credit unions could own the same asset from the same issuer and all come up with different quality ratings. This inconsistency is nonsensical.

This also opens credit unions to the subjective interpretations and biases of individual examiners. What processes will the NCUA employ with its examiners to ensure standardized examinations relating to the quality of its investments and to the ratings of counterparties? Are current examiners competent to evaluate the capacity of credit union investments? If not, is this going to increase the cost of examinations without providing additional value?

This proposal leaves no room for a true quality assessment because credit unions will spend an inordinate amount of time trying to protect themselves from the subjective findings of examiners and further narrow investment opportunities to a very small number of extremely high quality assets. This may have the unintended effect of drastically reducing investment income, again, to the detriment of credit unions and their Members.

As proposed, this rule will create uncertainty in secondary market investments. Credit unions may make a positive determination on an investment or a counter-party after conducting their due diligence only to have an examiner, using his/her subjective biases, determine that the investment or counterparty is not strong enough.

Furthermore, credit union executives have open lines of communication and regularly share in the cooperative spirit of the movement. One examiner's finding that a particular investment is impermissible may inevitably result in another credit union dropping certain investments in anticipation of upcoming examinations; all within an effort to mitigate potential examination findings when, in fact, another examiner will not take issue with that particular investment. This creates unnecessary uncertainty and instability for credit unions.

Alternatives

NCUA has asked commenters to propose alternatives to the narrative basis for the replacement of NRSRO ratings. Of the eight elements that commenters are asked to consider is whether the alternative provides "for a reasonable and objective assessment of the likelihood of full repayment of principal and interest over the life of the security..."

While we are wary of the regulatory use of the terms "reasonable and objective" due to the difficulty of a "real world" application of these terms, we have two alternatives for NCUA to consider:

- 1) In order to create a regulatory scheme that retains the certainty and stability of NRSRO ratings, the NCUA should consider publishing a regularly updated list of acceptable investments upon which credit unions can rely on as "safe harbor" investments. Credit unions would still be permitted to venture out to other investments if they have the resources to conduct appropriate due diligence, but at least smaller credit unions will still be able to invest without the fear of examination findings looming over them.

For counter-party transactions, perhaps the NCUA could establish its own scoring system upon which credit unions could rely on in developing the criteria for its due diligence plan. The advantage of this option would be that the potential for overly relying on NRSRO ratings, (which was cited by Congress as the impetus for this provision of the Dodd-Frank Act) would be removed, while still maintaining a system that provides credit unions with certainty that the decisions made on the strength of counter-parties will meet regulatory expectations.

- 2) Another alternative is to allow credit unions to rely on NRSRO ratings as a baseline for the pre-qualification of an investment only, and require supplemental internal standards using ancillary sources for the final vetting of the investment. This option provides credit unions with a standardized baseline from which they can begin additional due diligence, while avoiding investments that do not meet baseline criteria.

We believe that this option would satisfy the statutory mandate of the Dodd-Frank Act because it would remove the NRSRO references from NCUA regulations, as the Act requires. There is nothing in the Act that prohibits such reliance in other contexts; removal from the regulations is all that is mandated by Congress.

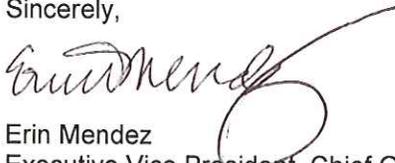
In closing, we would like to point out that NCUA has positioned itself as the first of the regulatory agencies to issue a proposed rule to implement this Dodd-Frank provision. We believe that a more prudent course of action for the NCUA to take would be to wait for the other financial regulators to act and then issue an inter-agency proposal in conjunction with the other agencies.

Re: Proposal to Remove References to Credit Ratings from NCUA Regulations
April 25, 2011
Page Four

At a very minimum, the NCUA should wait for the other regulatory agencies to at least propose their implementing regulations prior to finalizing a rule that has the potential of creating great uncertainty and instability for credit unions as a whole. By issuing a joint proposed rulemaking, or at least examining the proposals of other regulatory agencies, the NCUA may obtain additional insight into alternate methods of implementing this requirement while minimizing the unintended consequences which the current proposal will cause.

Thank you again for the opportunity to express our views on this proposed rulemaking. Please feel free to contact us if we can be of further assistance.

Sincerely,

A handwritten signature in black ink, appearing to read "Erin Mendez", with a large, stylized flourish at the end.

Erin Mendez
Executive Vice President, Chief Operating Officer
SchoolsFirst Federal Credit Union

cc: Credit Union National Association (CUNA)
California/Nevada Credit Union League (CCUL)