

National Credit Union Administration
12 CFR Parts 703, 704, 709, and 742
Removing References to Credit Ratings In Regulations; Proposing
Alternatives to the Use of Credit Ratings

The following are our comments on the proposed rule, which are limited to **12 CFR Part 703**:

1. The **Summary** made no mention of the proposal to further limit investments in municipal obligations, European financial option contracts, and mortgage note repurchase transactions, even though the proposed limitations could have a significant impact on some FCUs, particularly as those limitations would apply to investments in municipal obligations.
2. The discussion of Definitions contains the statement that “An FCU wishing to purchase a *small business related security* must demonstrate that it meets the 3(a)(53) requirements, as determined by the SEC.” It is our understanding that investments in *small business related securities* have been prohibited by Section 703.16(f) of the NCUA Rules and Regulations since at least January 1, 1998.
3. The proposed concentration limits for investments in municipal obligations make no distinction between *general obligations* and *revenue bonds*:
 - *General obligation bonds*. These obligations are secured by the full faith and credit of the issuer (state, city or other political subdivision) and are usually supported by either the issuer’s unlimited or limited taxing power. General obligation bonds are often voter-approved.
 - *Revenue bonds*. Principal and interest are secured by revenues derived from tolls, charges or rents from the facility built with the proceeds of the bond issue. Public facilities financed by revenue bonds include toll roads, bridges, airports, water and sewage treatment facilities, hospitals and subsidized housing. These bonds are often issued by special authorities created for that particular purpose.

Section 107(7)(k) of the Federal Credit Union Act does make a distinction between general obligations and revenue bonds, allowing FCUs to purchase general obligations without limit while placing a single issuer limit on revenue bonds equal to **10.00%** of an FCU’s paid-in and unimpaired capital and surplus.

NCUA should also distinguish between general obligations and revenue bonds in the context of the proposed rule. Needless to say, this would be more in keeping with the intent of Congress as expressed in Section 107(7)

(K) of the FCU Act. For example, the following limitations might be considered consistent with the FCU Act in the context of the proposed rule:

- *General Obligations* – Not greater than **100.00%** of net worth
- *Revenue Bonds* – Not greater than **50.00%** of net worth.

The proposed single issuer limitation of **25.00%** of net worth may be appropriate for either general obligations or revenue bonds, although one might argue that there should be a distinction between general obligations and revenue bonds with respect to the single issuer limitation as well.

4. NCUA may also wish to reconsider the proposal to further limit investments in European financial options contracts and mortgage note repurchase transactions inasmuch as it has not demonstrated that FCUs have experienced (or are expected to experience) significant risk exposures in either of those markets. That said, the present investment limits for European financial options contracts and mortgage note repurchase transactions would not appear to be unreasonable.
5. Subject to safety and soundness considerations, the final rule should contain a “grandfather clause” for existing holdings of municipal obligations, European financial option contracts and mortgage note repurchase transactions that may be outside of the final rule. Contrary to the statement that “Since most munis are exempt from income taxation, and FCUs are tax exempt entities that cannot take full advantage of the tax exempt status of munis, it is unlikely that any particular FCU would desire to hold municipal securities in amounts that would exceed these proposed limits”, there are FCUs that presently hold municipal obligations in excess of the proposed limits. Such a “grandfather clause” would be consistent with past agency practices.
6. The final rule should clarify that a FCU may still consider an external assessment of creditworthiness when evaluating the capacity of a municipality to meet its financial obligations.

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