



Valerie Tomasi Auerbach  
Michelle M. Bertolino\*  
F. Scott Farleigh  
Laury Hennings◇  
Michelle Holman Kerin\*  
David R. Ludwig  
Kimberley Hanks McGair\*  
Peter C. McKittrick  
Robert N. Muraski  
Kathryn P. Salyer\*  
Dean T. Sandow\*  
Karen E. Saul\*  
Tara J. Schleicher\*  
Harold B. Scoggins, III\*  
Connie L. Speck  
Brad C. Stanford\*  
Brian R. Witt\*

121 SW Morrison Street  
Suite 600  
Portland, Oregon 97204-3136  
(503) 228-6044  
Facsimile (503) 228-1741

Central Oregon Office  
Five Pine Station  
750 Buckaroo Trail, Suite 203  
P.O. Box 1866  
Sisters, Oregon 97759  
(541) 549-4958  
Facsimile (541) 549-4959

\*Oregon and Washington Bars  
◇Of Counsel

September 27, 2005

### **Via Email**

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

Re: Comments on Proposed Rule Part 741.8

Dear Ms. Rupp:

We are writing to provide comments in response to the July 21, 2005 Notice of Proposed Rulemaking and Request for Comments regarding NCUA Regulations Parts 741 and 712. Farleigh Witt represents hundreds of credit unions and credit union service organizations, both state and federal, on the west coast and throughout the country. However, we write on our own behalf, and not on behalf of any particular credit union or other client. In addition to the proposed changes to Part 741.8, NCUA requested comment on possible changes to Part 741.3(a)(2) and Part 712. We are responding to those requests.

### **Non-Conforming Investments**

Current NCUA regulations require federally insured state chartered credit unions ("FISCUs") to establish special reserves when they acquire investments that are permitted under state law, but not permitted for a federal credit union. The Supplementary Information indicates that the NCUA is concerned that such investments may raise safety and soundness concerns. We recognize the safety and soundness concerns that can be raised by risky credit union investments. However, we believe that requiring all state chartered credit unions to conform to the federal credit union investment rule is an unduly restrictive approach to the problem. In addition to being unduly restrictive, this approach also impairs the effectiveness of the dual chartering system.

The same investment may pose different levels of risk for different credit unions, depending on the size of the credit union, the size and diversity of the credit union's investment portfolio, the sophistication of the credit union's ALM policies and personnel, environmental factors, and other issues. Unquestionably, there are investments that should not be permissible for any credit union. For state chartered credit unions, however, we believe that the decision of

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which investments are prohibited should remain in the hands of the state regulator. Safety and soundness concerns can be addressed in a number of other ways that do not encroach on the authority of state regulators under the dual chartering system.

The current method of requiring a special reserve for non-conforming investments is one solution. We understand NCUA's concerns regarding the workability of this solution under generally accepted accounting principles ("GAAP"). However, credit unions can properly manage risk associated with non-conforming investments if they have adopted sound and prudent ALM policies, and approached such investments in accordance with those policies using prudent investing strategies and procedures. The NCUA can oversee a credit union's implementation of such policies, procedures, and strategies with respect to credit unions holding non-conforming investments on a case-by-case basis, requiring corrective action when necessary. This will allow state chartered credit unions to take advantage of investment opportunities that may be sound under appropriate circumstances, even if they are not available to federal credit unions.

### **CUSO Regulation**

NCUA has also requested comment on a potential change in the current CUSO regulation, 12 C.F.R. Part 712. The notices states that "NCUA is concerned about the potential liability for state chartered credit unions, and the resulting potential liability for the NCUSIF, if their CUSOs do not observe corporate separateness." We recognize the NCUA's legitimate concern about the impact of CUSO investments on a credit union's financial position. However, the proposed response goes far beyond the issue of corporate separateness, and unduly intrudes on the authority of states to regulate CUSO investments by state chartered credit unions.

The "corporate separateness" requirements of NCUA Regulations § 712.4 are designed to ensure that a credit union's direct financial risk related to a CUSO is limited to the amount of the credit union's investment in and/or loans to the CUSO. This is the same reason for the requirement in Section 712.3 that a CUSO be structured as a corporation, limited liability company, or limited partnership. These are sound requirements that, when adhered to, should effectively limit a credit union's direct financial exposure to the amount of its investment in and/or loans to a CUSO.

The other limitations contained in Section 712.3 include the "customer base" limitation, which requires that the CUSO "primarily serve" credit unions, members of the owner credit union, or members of credit unions that have contracts with the CUSO. They also require the CUSO to provide agreements that the CUSO will obtain an annual opinion audit, account for transactions in accordance with GAAP and provide the NCUA with unfettered access to the CUSOs books and records. If the NCUA's concern is with the financial risk posed to the credit union by ownership of the CUSO, and the credit union has taken appropriate steps to maintain corporate separateness and limited liability, these additional requirements are both overly

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intrusive and unnecessary. If a state adopts customer base rules different from the NCUA's, and does not require opinion audits or GAAP accounting for CUSOs, a state chartered credit union should not be prevented from investing in a CUSO under those rules, as long as the credit union has taken appropriate steps to limit its risk to the amount of its investment and loans. At that point, the NCUA's safety and soundness concern is satisfied.

In other words, we believe that it would be appropriate for the NCUA to require state chartered credit unions to adhere to Sections 712.3(a) and (c) and 712.4. However, we do not believe it is appropriate or necessary for the NCUA to apply the customer base, accounting, and access requirements of Sections 712.3(b) and (d) to FISCUs.

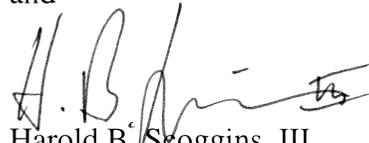
We appreciate the opportunity to provide this comment.

Sincerely,



Brian R. Witt  
[BWITT@FARLEIGHWITT.COM](mailto:BWITT@FARLEIGHWITT.COM)

and



Harold B. Seoggins, III  
[HSCOGGINS@FARLEIGHWITT.COM](mailto:HSCOGGINS@FARLEIGHWITT.COM)

HBS/jlb