March 8, 2010

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

Re: Response to Proposed Rule for Corporate Credit Unions (12 CFR Part 704)

Dear Ms. Rupp:

The Michigan Credit Union League (MCUL) thanks the NCUA Board for the opportunity to comment on the proposed changes to the regulations for Corporate Credit Unions (Corporates). As background, MCUL represents approximately 335 credit union members based in Michigan.

We send this letter in cooperation with Central Corporate Credit Union (CenCorp) the primary corporate credit union serving approximately 330 credit unions based in Michigan. MCUL supports CenCorp's position that most of the new investment concentration and/or sector limitations proposed address the credit risk issues that resulted in the large losses at Corporates in recent years. The proposed rule goes further to establish other regulations that impact Corporate operations in other areas. The proposed restrictions on Asset/Liability Management (ALM) and earning retention requirements are of particular concern. We have been advised that for CenCorp alone, its projected net income from operations (approximately $4 million annually) would be eliminated if it were to operate under the guidelines as proposed. This would reduce the value generated for members.

The proposed rule covers a wide range of Corporate activities. Of note, it doesn't specifically cover the longer-term funding needs of US Central nor the existing interrelationship between Corporate operations and US Central during the transition to the new regulatory environment. We believe the lack of proposed information is essential to framing and understanding a well balanced resolution.

MCUL organized a task force of credit union officials and met with CenCorp senior staff for a review of the rule and comments that would form the basis for their letter and ours. Thus our comments are organized to be consistent with and supportive of CenCorp's letter. The significant areas of concern (ALM and capital) are presented first. Comments of areas of lesser concern are presented next. References to the sections that a comment relates to are indicated throughout.

Asset/Liability Management (Section 704.8)

Interest rate risk limitations for financial institutions typically consist of a maximum percentage change in the institution's Net Economic Value (NEV) as the result of a 300 basis point interest rate shock. The NCUA uses a similar methodology as a base. It then proposes the addition of a “credit spread widening” provision and imposes a two-year weighted average life limitation on the Corporate’s investment portfolio. The combination of traditional shock test with the other restrictions nearly eliminates a Corporate’s ability to invest in floating rate investments.

As background, the rates paid on floating-rate assets typically purchased by Corporates change based on a referenced index (usually the one-month LIBOR rate). The rate paid is a margin (spread) over the particular index. The margin demanded by the marketplace can widen or narrow over time (not for the security after it has been issued). This new provision requires that a change in the market value of a floating-rate investment resulting from a credit spread widening of 300 basis points be included in the NEV calculation (i.e., in addition to the interest rate risk limitation).

In the *standard* NEV shock test, floating-rate assets have minimal interest rate risk because of their frequent (generally monthly) rate resets. The implementation of the spread widening shock in the proposed rule would substantially eliminate the interest rate risk limiting benefit of investing in floating-rate investments and force Corporates to shift floating-rate investments into overnight investments. As indicated in its letter, CenCorp currently expects to own an average of $800 million in floating-rate assets in 2010. These investments are expected to earn 33 basis points more than overnight investments. The reduction in annual net interest income from a shift away from floating-rate to overnight investments equates to $2.6 million. This is just over *half* of CenCorp’s projected income in 2010.

In the preamble to the proposed rule (pages 99 – 101), the NCUA sets forth an “example Corporate” that could theoretically earn 21 basis points annually and meet the earnings retention requirements in the regulation. MCUL supports CenCorp’s position that the example contains some unrealistic assumptions on the availability of securities, average rates, and weighted average lives. In summary, a Corporate could not actually attain the earnings under the scenario presented by the NCUA.

With CenCorp as an example, it estimates that its net income would decline by approximately $4 million in total if it were to operate under the proposed rule. The bulk of this difference is due to the decline in floating-rate investments noted above. The remainder is due to investment changes and reduction in CenCorp’s asset size due to other provisions in the proposed rule. CenCorp would operate near breakeven unless it significantly reduced returns to members or made other changes!

Investments are subject to the inherent risk of credit spread changes in the marketplace like any other interest-earning asset on a financial institution’s balance sheet. Barring a forced liquidation, a financial institution manages this risk in the normal course of business. Instead of adding this credit widening concern to interest rate measurement, MCUL recommends Corporates be excluded from the interest rate shock testing. Agency securities have historically not been as susceptible to credit spread widening. Agency spreads actually decreased slightly during the investment market upheaval in late 2008. If a Corporate can obtain adequate liquidity from other sources, then the credit spread widening on a portion of its investments (that wouldn’t need to be liquidated) would be manageable. As suggested by CenCorp, MCUL believes that a limit on non-agency securities as a multiple of capital would be a better approach if credit spread widening is considered significant.

Floating-rate assets typically have original weighted average lives in excess of two years. This would restrict the purchase of these types of securities, including agency-backed, and may lead to the purchase of other securities with lesser yields and/or more credit risk. MCUL believes that other restrictions within the proposed rule appropriately limit credit and liquidity risks. This two-year limitation is not necessary and should be eliminated.

Corporate Capital[1]

The existing Member Capital Accounts (MCAs) will no longer qualify as regulatory capital. Minimum qualifying capital requirements are based on the Basel standards that were developed for commercial banks. This includes a minimum 4% leverage ratio (same amount as the current total capital ratio) and a risk-based capital requirement (not part of the current rule). The new qualifying capital is not subject to periodic (annual) adjustment like existing MCAs and requires regulatory approval to redeem early (even if the Corporate exceeds the minimum capital requirements after the redemption). Unlike current Basel and GAAP standards, capital investments in subsidiaries/CUSOs must be immediately deducted from capital. The proposed rule also sets milestones for the building of retained earnings.

The NCUA's basic rationale for the proposed changes is that the permanence of capital and a risk-based capital standard would have mitigated the losses at Corporates in the past two years. MCUL supports CenCorps's conclusion that in actuality, the losses incurred by Corporates resulted almost exclusively from estimated losses on investments. The existing contributed capital accounts of members at Corporates absorbed losses in a similar fashion as the capital accounts defined under the proposed rule would have if they were in place previously. As CenCorp states in its letter, it would have complied with the risk-based capital requirements as presented if they had been in force previously. We believe other Corporates would have complied also. The capital impairments incurred by Corporate members would have taken place regardless of the form of contributed capital.

The NCUA is proposing to apply commercial banking capital standards to a wholesale cooperative system. The deduction of any capital invested in a Corporate CUSO and the future requirement that a portion of capital consist of retained earnings makes the capital definition even more restrictive than the Basel standards. Other provisions in the proposed rule limit the risks assumed by a Corporate to levels that are significantly less than a commercial bank. This is an inflexible capital structure, particularly when (1) you consider that there will likely be consolidation at Corporates and natural-person credit unions in the future and (2) you compare it to a similar system such as the FHLBs.

Coupled with the credit concentration limits and other proposed provisions, a Corporate has little opportunity to generate earnings. This is alarming. As stated previously, CenCorp doesn't believe it would meet the future minimum retained earnings requirements in the proposed rule as written. As a result, it is expected that many members would not likely elect to convert/recapitalize the Corporate with the limitations in the proposed rule.

Although the existing MCAs with a three-year notice provision have absorbed recent investment losses at Corporates, this time period is short in relation to the term of some Corporate assets. A five-year notice would be more appropriate for capital purposes. The aggregate capital levels proposed (4% leverage and 8% risk-based ratios) are appropriate. MCUL supports CenCorp's belief that a five-year contributed capital structure as opposed to paid-in-capital would strike an appropriate balance for member and regulatory purposes. Redemptions by the Corporate should be allowed, provided the Corporate is meeting the minimum capital requirements after any redemption.

From a NCUSIF standpoint, contributed capital acts in the same capacity as retained earnings. The building of retained earnings is typically a decision made by the organization's Board with any concerns of the regulator handled through the regular examination process. MCUL doesn't believe that the portion of capital that is retained earnings should be designated within the regulation. The retained earnings milestone in the regulation should be eliminated with any regulator concerns addressed during the examination process.

[1] This is covered primarily in Section 704.3, but also includes definitions in Section 704.2.

Regarding capital contributed to CUSOs, this should not be deducted from the capital ratios. This would be consistent with the treatment of capital investments under GAAP.

Authority of the NCUA Director of Corporate Credit Unions

The proposed rule contains several references[2] that authorize the NCUA Director of the Office of Corporate Credit Unions to take action that varies from regulation at his/her discretion without any stated avenue for appeal. The consequences of such action could potentially be severe and we believe there should be some level of review and concurrence of this action from the NCUA Board or other senior staff at the NCUA.

Early Redemption of Member Certificates (Section 704.8(c))

The proposed rule limits the amount paid on the early redemption of a certificate to “the principal amount of the certificate plus accrued interest.” Under the existing regulation, a member redeeming a certificate early could receive more than that if market rates had moved lower since the certificate was issued. Corporate certificates “compete” with other securities available in the marketplace such as agency securities. These securities can be sold at a gain. Thus, this proposed limitation would put the Corporate certificates at a disadvantage versus other securities.

Due primarily to other provisions in the proposed rule, we believe some Corporates would begin reducing the amount of longer-term certificates that they issue. This would reduce the impact of the new limit on early redemptions if it were included in the final rule. However, we understand that some other Corporates issue more certificates than CenCorp. This provision may restrict their funding sources and contribute to a liquidity concern in the future. MCUL supports CenCorp in that the payment of gains on certificate redemptions doesn’t add to risk and should be permitted. The prohibition on gains should be eliminated from the final rule.

Limit on Investment from an Individual Member (Section 704.8(k))

The proposed rule limits investments received from an individual member to 10% of a Corporate’s assets. We are not sure about other Corporates, but we are advised that CenCorp doesn’t have an individual member that exceeds this threshold. We believe that the risks of this type of concentration are already addressed in the other provisions in the regulations.

Issuer Concentration Limits (Section 704.6(c))

The proposed rule establishes a limitation on the investment in a single obligor (excluding certain investments like agency securities) equal to 25% of a Corporate’s capital with certain exceptions. Corporates with payment system operations often present transit (forward collection) items through correspondent banks. These funds are initially credited to an account at the correspondent bank and then consolidated back to the Corporate when available. Because the majority of the transit items are images, the credit and movement of funds back to the Corporate occur on the same day. Accounts at correspondent banks that facilitate this type of payment system activity should be added as an additional exception to the single obligor limit.

Most Corporates are subject to fairly predictable but large inflow and outflow of deposits on a seasonal basis. The ability to invest a relatively large amount of funds (e.g. up to $1 billion at CenCorp) for several months during the year is necessary to provide an adequate return to members. These funds are reinvested primarily at the FRB or US Central today. We expect that these funds will need to shift towards Fed Funds transactions in the future. The 25% issuer limitation would require numerous counterparties as financial institutions continue to consolidate and reduce the investment options available. Considering the low risk profile of the Fed Funds

[2] Section 704.3(d)(4)(v), 704.3(e)(3), 704.4(d)(3), 704.4(d)(3)(ii), 704.4(d)(4) and 704.4(k)(2)(v).

market, we recommend that a single obligor limit of 200% of capital for transactions with maturities less than 90 days would be appropriate.

Slowdown in Investment Prepayment Speeds (Section 704.8(f))

The credit risk concentration limits and other provisions in the proposed rule will necessitate the movement of investments to other sectors in the future, including asset-backed securities (ABSs). The proposed rule calls for a new NEV limitation based on 50% slowdown in the prepayment speed of securities. This includes ABSs secured by auto and credit card loans that historically have had little variability in their prepayment speeds. MCUL supports CenCorp's belief that the interest rate risk limitations in Section 704.8 are sufficient, and this 50% slowdown in prepayment speed should be eliminated.

Permissible Corporate CUSOs (Section 704.11(e))

The proposed rule limits CUSO activities to brokerage, investment advisory or other activity approved by the NCUA. It doesn't address existing CUSOs at Corporates that may not fit in such categories. For example, CenCorp has a business services CUSO that has been in operation for over five years. This would require NCUA approval under the proposed rule. MCUL suggests that existing Corporate CUSO operations be grandfathered in the proposed rule.

Borrowing Limitation (Section 704.9(b)(1))

Borrowing is limited to 30 days for "liquidity purposes" in the proposed rule. CenCorp has historically borrowed funds for a few weeks during its low liquidity period in late summer. It has also borrowed to offset the interest rate risk of term loans (over one-year) to members with similar term borrowings. As written, this latter activity would be prohibited. It would also restrict a Corporate from borrowing for over 30 days even if it were better economically. MCUL believes that other provisions in the proposed rule adequately encompass any ALM or liquidity concerns involving borrowing and that this provision should be deleted.

Board Member Terms (Section 704.14(a)(4))

The proposed rule limits Corporate Board members from serving over six years. If applied, the average tenure of the Board would be expected to move towards three years as the rule is completely phased in. Using CenCorp as an example, the majority of its existing Board members would not be able to seek re-election when their term expires. The imposition of term limits would be disruptive to CenCorp's ongoing governance and doesn't add any value, and thus MCUL believes term limits should be deleted.

Effective Dates for Transition

As indicated in the proposed rule, the effective date of most provisions is immediately upon publication of the final rule. Without knowing what the final rule will entail, an immediate effective date will likely put a Corporate into non-compliance regarding some provisions. For example, CenCorp's business services CUSO is not permitted under the proposed rule as written. CenCorp wouldn't know if it is actually not permitted until the final rule is published. It would not be in compliance at that point. CenCorp suggests that adequate time be incorporated into the final rule to allow for transition and compliance.

Conclusion

While the experience of recent years indicates a need for changes at Corporates, the proposal surfaces at a time of great uncertainty in the financial markets and in the valuation of investment securities owned by Corporates.

An effective regulatory framework balances the need to limit the aggregate risks that can be assumed with the need to permit the Corporate to properly assume and manage reasonable risks for the benefit of members.

The proposed rule restricts Corporate operations to the point that little risk is assumed. The proposed restrictions are such that they don't allow a Corporate to have the authorities/tools needed to generate much value on behalf of members. We urge the NCUA give this concept its every consideration in the next step in reviewing the comments it receives.

Thank you for this opportunity to comment.

Sincerely,

CEO
Michigan Credit Union League & Affiliates (www.mcul.org)
CUcorp, CU Village, HRN