Missouri Credit Union Association

February 18, 2009

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

Dear Ms Rupp:

On behalf of Missouri's credit unions, thank you for the opportunity to comment on the Advance Notice of Proposed Rulemaking (ANPR) on National Credit Union Administration (NCUA) regulation, Part 704 regarding Corporate Credit Unions. The current turmoil of the financial markets is unprecedented; and therefore, any actions taken by the NCUA should be carefully and thoroughly analyzed. We urge you to use extreme caution prior to implementation of any action to avoid unintended consequences for credit unions that are already experiencing negative financial trends resulting from the market dislocation. The following comments are segregated by topic addressed in the ANPR:

1. The Role of Corporates in the Credit Union System

This section asks for comments on the second or wholesale tier of the corporate network addressing appropriate capital levels, liquidity and investment authorities and structure validity, including possible modifications based upon the investment and payment system services.

To clarify, it was a combination of the significant deterioration in the credit markets and mortgage securities, the loss of confidence in the financial markets, and lack of appropriate due diligence and oversight of securities rating agencies that were the underpinnings of the market dislocation. The fact that some corporate credit unions are pass-through organizations of U.S. Central Federal Credit Union and others employ more aggressive investment strategies should be viewed independently. To eliminate the second tier corporate would not solve the current economic problems. Many credit unions large and small rely on their "local" corporate for investments, payment systems and other financial services. Eliminating them would leave these credit unions to competitors and other financial intermediaries who do not have the credit union industry's best interest in mind; and would only serve to subject credit unions to less affordable options. Predetermining the appropriate number of corporate credit unions is arbitrary, at best. The appropriate number will naturally be determined by active forces within the marketplace, based upon the value proposition of each corporate. The system has been consolidating and evolving, and will continue to do so, without intervention. By requiring credit unions to have paid-in-capital (PIC) in any corporate that they use, would precipitate any determinate consolidation. Small, medium and large credit unions all need an equal voice in shaping the corporate network.

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The primary purpose of organizing the corporate credit union network was to be a source of liquidity and be a safe investment alternative for credit unions. NCUA should focus on keeping the amount of non-matched investments at a level that does not jeopardize its ability to maintain positive cash flow and meet liquidity needs of its member credit unions. The NCUA should focus on restoring the liquidity and safe investment practices of the corporate credit union network. This should be done without penalizing the corporate credit unions that didn't put the strain on the insurance fund; and without rewarding those corporate credit unions that took on excessive risk.

In regard to corporate credit union investment strategies, corporate credit unions that want to assume more risk in their investment strategies should be subject to increased regulatory scrutiny, and be required to build and maintain the appropriate levels of capital accordingly. What is relevant to today's risk environment is having adequate capital levels, cash flow, and an adequate assessment of risk. Corporate payment system services and investment services should both be offered and are consistent with the needs of the credit union community. Corporate credit unions that acted on a pass-through basis should not have their ability to earn revenues from matched book certificates spread eliminated, and their ability to provide competitive correspondent services significantly hampered.

NCUA should require annual requalification for expanded investment authorities to control and mitigate risk to the system. Risk-based reserve requirements would be the appropriate reserve requirements to follow, along with cash flow analysis to ensure the liquidity needs of the credit union system are adequate. NCUA, if need be, should use third party qualified bond and security analysis organizations to assist the agency with risk assessment, and the cost of this should be paid for by those corporate credit unions that choose aggressive investment strategies.

Technology and electronic settlement allows credit unions to transact business without geographic boundaries. Any action to go back to restricted Fields of Membership (FOM) would be a step backward. As noted above, the current problems are not FOM related, but rather economic and Asset Liability Management (ALM) related, and NCUA should focus on improving ALM regulatory oversight.

Regarding whether or not there is a continuing need for a wholesale corporate credit union (US Central FCU), we feel it is a necessary component of the network. US Central is the national settlement system for the industry. Would elimination of this component lead the credit union system to recreate what currently exists? The NCUA had a resident examiner at US Central; it appears that tighter controls, regulatory oversight and use of experienced investment portfolio experts to assess and mitigate risk would have addressed the situation at hand. However, it is necessary to underscore that US Central was a AAA rated institution and one of only a few nationwide. This only serves to uphold the concept that the sophisticated investment vehicles that were offered were over-rated by the security rating agencies and that those vehicles were not sufficiently understood by both examiners and investors.

2. Corporate Capital

In respect to core capital, and what level should be considered appropriate, it should be based upon the level of risk exposure the corporate credit union assumes. If a corporate credit union stays at the lowest level of risk, whereby it operates a closely matched book of business, the current requirement of 4.00% most likely would be sufficient. Risk-based capital levels should be similar to what other financial regulators require; however, obviously required capital levels have been shown to be inadequate in light of what exposure exists and should be reassessed for all financial institutions. The current 12 month moving average of assets seems to be a reasonable tool to use for determining capital to asset ratios. Corporate credit unions should be required to manage their balance sheet just as natural person credit unions are required to do. This would ensure there is adequate capital to meet liquidity needs. Due to the fluctuations in assets on a month to month basis using the 12 month moving average should help to smooth out the jumps and drops. In addition, corporate credit unions should be allowed to seek additional paid-in-capital to help it manage its capital level when extreme increases in assets occur.

In regard to whether or not a corporate credit union should be limited to providing services only to members maintaining contributed core capital, which is assumed to include membership shares or paid-in-capital, we definitely think maintaining a capital requirement should be required. This is the structure that natural person credit unions have to operate under and it works quite well. It would also help to keep corporate credit unions operating as cooperatives and tax-exempt entities. However, other credit union system entities, such as CUNA, CUNA Mutual, and Leagues need to be able to receive services from corporates. This could be accomplished by allowing them to purchase membership shares or paid-in-capital, or allow a thrift account exception similar to today. These other credit union entities have played a vital role in the development and support of the corporate credit union network, and they continue to today, and therefore should not be shutout of the network and forced to use system competing public entities for financial services.

Membership capital should be a core structural component for corporate credit unions. Modifications to the structure to allow it to be counted as tier-two capital should be pursued. This would increase a corporate credit union's ability to raise capital beyond just undivided earnings thereby strengthening its ability to handle market stresses. In order to further strengthen the ownership concept, these shares should be at risk and conditioned on the ability of the corporate credit union to repay before a credit union could withdraw. In addition, as stated earlier, natural person credit unions should be required to maintain the minimum membership share amount in order to receive services from a corporate credit union.

3. Permissible Investments

Many natural person credit unions lack the investment expertise needed to make investment decisions beyond a certificate of deposit or a Treasury and therefore look to corporate credit unions for a way to increase their yield. Corporate credit unions play a vital role in this respect and should be able to continue to serve investment needs of the credit union community. While the current stress on capital is tied to asset-backed investments it is an unprecedented turn of events that created the dislocation of the markets, it must be stressed that not only corporate credit unions' balance sheets have been affected, but all financial intermediaries' balance sheets globally. To tie corporate credit unions' hands from making sound investments using asset-backed securities would severely hamper credit unions' ability to be competitive in a normal competitive financial operating environment. As for as modifying existing permissible investments and prohibitions we feel the tighter controls over levels of capital and risk-based reserving should be instituted with greater emphasis placed on cash flow analysis and investment/liability matching to reduce down side risk.

4. Credit Risk Management

It is true that a large portion of the root cause of the disintegration of the financial markets is poor performance of rating agencies, and the reliance on their analysis and reports by financial institutions and financial institution regulatory agencies. Hopefully, the rating agencies will be under greater regulatory oversight and scrutiny going forward. We are not professing the abandonment of the use of rating agencies, but a requirement to seek more than one rating for their investments and the corporate credit union should use the lowest rating to meet minimum rating requirements of Part 704. Specific concentration limits should be established for sectors and issuers. Regarding corporate credit unions' investment portfolios, corporates should be required to obtain independent evaluations. Regarding concentration limits and standards for contractors, we do not feel adequately qualified to offer an opinion but encourage the NCUA to seek advice from independent finance professionals.

5. Asset Liability Management

The market dislocation happened very rapidly and stress test and income modeling tools may not have been able to accurately provide reliable estimates, but by using specific exit points they may have helped to reduce losses. We feel that stress testing and modeling tools should be required.

6. Corporate Governance

Once again, the most respected financial experts that sat on the boards of financial services entities were unable to predict the occurrence and impact of this unprecedented economy. The current level of expertise on multi-billion natural person credit unions is parallel to corporate credit unions and US Central. CEOs of natural person credit unions sit on corporate credit union boards, CEOs of corporate credit unions sit on US Central's board. I believe that at both levels of the corporate system there is adequate financial expertise. Board members should be elected by those they serve i.e. the membership that comprises the entity, which is consistent with credit union structure. Rather than require all having special expertise, a logical approach would be to require corporates to use credible outside expert analysis and recommendations as was mentioned previously throughout this response. The corporate board would have to do due diligence on these external experts and be accountable for actions taken. In regard to term limits, the same issue of limited available talent is a negative to this idea. We do not feel that paying board members would guarantee quality and could pose the risk of self-interest or corruption. As for executive compensation, in our state our corporate credit union already has a requirement to file an annual 990 and in that report it lists the highest paid officers of the corporation. Transparency continues to be paramount and disclosure should be required.

The underlying assumption that by not having an outside director, the devaluing of corporate assets would have been prevented is not valid. Outside directors are often appointed to other industry boards of directors and they are selected because of the objectivity and expertise outside that specific industry. This brings diversity of opinion and perspective which positively contributes to organizational effectiveness and the ability to assess the impact of board actions on other system related entities and the public.

Closing Comments

In closing, we want to reiterate that it is critical that the NCUA act cautiously and deliberately when making decisions regarding changes to the corporate credit union network. Many highly paid and professed financial and investment experts from around the world made decisions that negatively impacted the financial services industry. No one predicted, or could possibly comprehend, the extent of the market dislocation that has occurred. The lesson learned is that sophisticated investment vehicles warrant more diligent oversight and understanding prior to any rating or offering. The NCUA must do all in its power to maintain safety and soundness while creating an operating environment that promotes growth and prosperity, which requires that corporate and natural person credit unions remain competitive in the financial service industry.

Sincerely,

Roshara J. Holub
President/CEO