FORUM®
CREDIT UNION

March 2, 2009

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

Re: Advanced Notice of Proposed Rulemaking to 12 CFR Part 704

Dear Ms. Rupp:

On behalf of the management and Board of FORUM Credit Union, I would like to take this opportunity to comment on the recently issued Advance Notice of Proposed Rulemaking (ANPR) to 12 CFR Part 704.

Corporate credit unions have long played an important and crucial role in the credit union system through the offering of a wide array of products and services to natural person credit unions that include, among others, payment and clearing services, investment services and, in many cases, a vital source of liquidity. However, the present economic circumstances affecting the overall U.S. economy and financial institutions in particular, does, in our view, present a legitimate basis for serious evaluation and reflection of the efficiency, necessity and effectiveness of the current corporate credit union system. We commend the NCUA for allowing natural person credit unions the opportunity to express our thoughts and viewpoints as a part of this evaluative process.

Not unlike other financial institutions across America and around the globe, corporate credit unions have experienced significant declines in the value of their investment portfolios over the past year. These reductions in portfolio values, combined with NCUA's recent decision to infuse $1 billion in capital into US Central and subsequent announcement of a NCUSIF premium assessment on natural person credit unions to recapitalize the share insurance fund to a 1.3% equity ratio, has shaken the confidence of many credit unions and caused some to seriously evaluate the stability and long-term viability of the corporate system as it is presently structured. Without losing the value the corporate system provides to natural person credit unions, this confidence must be restored.

While questions surrounding the cause of the current corporate crisis, the losses at US Central, and NCUA's immediate efforts to buttress the corporate system continue to linger and will undoubtedly be debated for some time, there can be no question that sound and prudent judgment dictates that NCUA and the industry carefully review the most effective role and structure of the corporate system going forward. The extensiveness of the ANPR process can facilitate that evaluation, and we encourage the agency to enter this process with an open mind to the views of natural person credit unions who wish to see the best corporate system possible available to assist them in serving our members.

To that end, we believe the issuance of the corporate ANPR is timely and are pleased to offer the following comments for the Board's consideration as it begins to formally review the corporate credit union system for possible structural and operational changes.

Role of Corporates in the Credit Union System

As stated before, corporate credit unions have historically provided and continue to provide natural person credit unions with a number of significant product and service offerings. Although in recent years many larger and more sophisticated natural person credit unions have become less dependent on the corporate system for their correspondent and other liquidity needs, the majority of credit unions still consider the corporate system as an integral part of the industry and rely heavily on their individual corporate credit union for vital services such as liquidity, payment systems and investments.

Therefore, while comprehensive restructuring may indeed be warranted, we would caution the agency to carefully consider the potential impact any significant restructuring could have on the ability of natural person credit unions to meet the needs of their members. With this caveat in mind, we would like to offer comment on some specific questions included in the ANPR associated with corporate restructuring.

<u>Liquidity</u>

It is our view that while liquidity should be considered a core service of the corporate system; however, the realities of today's marketplace shows clearly that liquidity should not be considered the only valuable service provided by corporate credit unions. Although efforts to preserve and strengthen the ability of corporates to provide adequate liquidity to natural person credit unions are likely warranted, it would be short sighted to attempt to achieve this objective by restricting the ability of a corporate to offer other types of products and services.

In our view, the long term ability of a corporate to meet the liquidity needs of its member credit unions is directly related to its ability to remain relevant and competitive in a dynamic financial marketplace. Therefore, we would urge the agency to preserve the ability of corporate credit unions to safely offer multiple product and service offerings to their member credit unions.

<u>Field of Membership Issues</u>

The ANPR suggests a premise that the current economic calamity facing the corporate credit union system is, in part, a result of NCUA's longstanding policy of allowing corporate credit unions to have national fields of membership. We strongly disagree.

We are unaware of any credible third party evidence or analysis that would support the notion that the existence of a national field of membership has caused a corporate credit union to engage in significant undue risk. National fields of membership have fostered healthy competition among the corporate credit union network that has resulted in valuable choice for natural person credit unions and has helped them mitigate concentration risk by providing them with access to more than one corporate credit union. Eliminating national fields of membership and returning to defined or regional fields of membership will clearly result in the restriction of competition and the removal of choice from the credit union system. The present crisis clearly shows the disadvantage to a natural person credit union of having only a single corporate choice. Concentration risk is enhanced for credit unions if they do not have the option of more than one corporate.

It is important to recognize that the current issues associated with credit risk and market devaluation are not unique to the corporate system and affect a much broader spectrum of the financial sector. To limit or restrict the ability of a corporate credit union to offer its products and services to natural person credit unions on a national level would be short sighted in our view and would not contribute to the mitigation of risk in any significant fashion. Such action would be devastating to corporates and natural person credit unions alike and would most likely serve to exacerbate the economic and systemic issues being faced today.

While continued consolidation of the corporate industry is expected and likely necessary in the current financial marketplace, we believe it is far more important to ensure that all corporates ultimately emerging from the consolidation process be strong, healthy and competitive regardless of their place of domicile.

Expanded Investment Authority

The ANPR questions whether the option for corporates to engage in expanded investment authority should continue in light of the current economic and investment crisis. For us, the question is not whether the expanded authority option should be eliminated. It should not, as corporates must be able to generate a return greater than a natural person credit union could generate or it would not be in a position to serve our needs or build capital for its own safety and soundness. Rather, the issue seems to be under what conditions and procedures should the authority be granted to an individual corporate.

Although additional modifications to the granting process may indeed be warranted, it is important to recognize the authorization of expanded investment authority has enabled many corporate credit unions to well meet the needs of their natural person credit union members for a number of years. Now is not the time to remove or limit the ability of a corporate credit union that can sufficiently demonstrate its ability to effectively manage and operate within expanded investment authority. To do so would significantly hinder the ability of the corporate network to compete in the financial marketplace and would most likely force natural person credit unions to seek other avenues for investments outside the industry. As past months have shown us, those other investment avenues may or may not be as strong as our corporate credit unions.

Rather than eliminate or reduce the ability of corporate credit unions to engage in expanded investment authorities, we would instead urge the agency to review current qualification standards and implement any necessary changes that would preserve the ability of corporates to safely engage in expanded investment authorities while maintaining their ability to compete in the financial marketplace. We would strongly urge the agency to consider heightened capital standards within a risk-based capital structure for corporate credit unions as part of this process. A properly weighted risk-based capital structure would enable NCUA to equate capital expectations with the expanded authorities granted to particular corporates.

The ANPR also asks whether corporate credit unions should be required to re-qualify for expanded authorities on a periodic basis. In light of recent events, we believe that, in addition to regular oversight, it would be sound regulatory practice for the agency to require corporate credit unions to sufficiently demonstrate their ongoing ability to manage the expanded investment authorities they have been granted. To accomplish this purpose, we would suggest that initial expanded authorities be granted for limited duration for three to five years with renewal applications required on two year intervals after the initial approval to ensure that the corporate has the appropriate management structure and sophistication to maintain the expanded investment authority going forward.

<u>Structure: 2-Tiered System</u>

In recent months there has been much discussion as to whether or not the current corporate structure adequately meets the needs of natural person credit unions. In particular, much discussion has ensued as to whether a wholesale corporate credit union is even necessary. Others have questioned whether there are too many retail corporate credit unions. These discussions are timely and the questions surrounding this topic should not be debated lightly in our view.

Without question the recent events at US Central have certainly brought about the need for a closer inspection of the necessity and role of corporate credit unions going forward, particularly the wholesale corporate credit union. However, it is also important to recognize the traditional role played by US Central and the retail corporates, as well as the impact the current system has on the credit union community as a whole.

Retail corporates have traditionally played an important and vital role in the success of their member credit unions by providing products, services and economies of scale. Corporates help their member credit unions remain competitive in a dynamic financial marketplace by providing deposit, loan, investment, processing and liquidity services, sophisticated investment vehicles along with technical and financial expertise. In a similar manner, US Central as the sole wholesale corporate credit union has served its member corporate credit unions with investment, liquidity, and cash management products and services, risk management and analytic capabilities, settlement, funds transfer and payment services. For many years this cooperative and competitive structure has served credit unions well. The current crisis does not require the elimination of a system that has served us so well for decades.

While structural changes may indeed be warranted that could potentially result in fewer corporates operating in a structure significantly different than what exists today, we would urge the agency to carefully evaluate any proposed structural changes not solely from a perspective of safety and soundness, but also from a member service perspective. The vast majority of credit unions, particularly those with small to moderate assets, rely heavily, and in most cases exclusively, on their corporate credit unions for the services referenced above. Therefore, any changes to the current structure must preserve the ability of retail corporate credit unions to meet the needs of their credit union members.

Although the merits of eliminating the necessity of a wholesale corporate credit union can be debated and perhaps even justified if the retail corporates are able to meet all needs of natural person credit unions by using depository and support services from sources other than US Central, it is absolutely critical that whatever structure ultimately emerges through the rulemaking process must be one that fosters competition and cooperation among the corporate network. This competition and cooperation within what emerges as the corporate network must be empowered in a manner that ensures sufficient resources necessary to maintain a thriving natural person credit union industry for the long term future.

Corporate Capital

We are pleased that the ANPR contemplates the revision of various definitions and standards for determining appropriate capital requirements for corporate credit unions. Capital modernization requirements for both corporate and natural person credit unions are long overdue and this issue warrants serious study and agency support going forward.

We have been supportive of the agency's efforts in recent years to seek statutory changes that would allow NCUA to implement a risk-based capital system for natural person credit unions to bring capital standards for credit unions more in line with other federally insured financial institutions. We believe a similar approach regarding corporate capital is also prudent and timely. Such changes are necessary from a regulatory point of view and are absolutely critical if credit unions are going to be able to be recognized as long term competitive players in the financial marketplace.

In our view, the current capital system for corporates is insensitive to the underlying risks and fails to properly align capital retention at the corporate with the risk being assumed by each individual corporate credit union. Because of this there is less incentive for corporate credit unions to engage in risk reducing activities. Clearly, if never more evident than today, changes in the current capital structure for corporates are absolutely necessary. Corporate capital requirements should be based upon appropriately weighted risk.

Corporate credit unions are one of the only remaining regulated financial institutions that are not subject to risk-weighted capital standards. While the capital requirements set forth in the international Basel accords may not be appropriate for corporate credit unions in their entirety, we strongly believe that the stated principles and objectives of Basel to create uniformity and a set of best practices in risk management provides an excellent framework for NCUA to consider as it evaluates the potentiality of a risk based capital system for the corporate credit union network.

Recognizing vast differences in banking structures across the globe, the Basel guidelines were intended to serve as a benchmark for an appropriate amount of risk-sensitive capital to protect against unexpected losses commensurate with the assumed risk by an institution, while providing for regulatory flexibility for regulators. Flexibility is a critical component in any risk based system and, if properly implemented, can assure that prescriptive rules do not inadvertently create perverse risk outcomes.

In keeping with this principle of regulatory flexibility, we believe it is essential for the agency to consider a principles-based application recognizing the unique attributes of corporate credit unions so as not to compromise their distinctive role in the larger credit union industry. Therefore, the challenge, as we see it, will be for NCUA to create an updated capital standard that not only supports safety and soundness for corporate credit unions, but is also flexible and requires capital levels directly related to the amount of risk on any particular balance sheet.

While capital modernization in the corporate system may include multiple variations and forms of capital, including core capital, membership capital, paid in capital and even other approved means of regulatory capital, we believe there are significant benefits to a risk-weighted capital standard. Under the current structure, dollar for dollar capital levels are required on every financial instrument on each corporate balance sheet, regardless of the risk profile of that instrument. Presently there is no capital incentive to manage a less risky profile.

The implementation of a risk-weighted capital system would more effectively assist NCUA in identifying those corporate credit unions with higher levels of risk and would in turn enable the agency to more effectively allocate its resources. In addition, the implementation of a risk-weighted capital standard would place corporates on a more comparable playing field for auditors, rating agencies, counterparties, legislative bodies, other regulatory bodies, government agencies and their natural person credit union members-owners.

Consistent with the long standing position of NCUA regarding natural person credit union capital reform, the implementation of a risk-based capital system for corporates is not unprecedented for NCUA and, unlike the case for natural person credit unions, would not require any statutory changes to bring it about. In our view, the implementation of a risk weighted capital standard for corporate credit unions can be one of the most proactive and far reaching actions the agency could take in restoring confidence in the corporate credit union system.

While we are making this case for risk based capital, it is our sincere belief that capital modernization of the same type is absolutely necessary for natural person credit unions as well. We encourage the agency to take a leadership role in promoting legislative action to authorize implementation of a risk based capital system and alternative capital sources for natural person credit unions.

Permissible Investments

The ANPR states that NCUA is considering whether corporate investment authorities should be constrained or restricted. Specifically, the ANPR questions whether a corporate's investment powers should be limited to that of a natural person credit union. We believe it would be misguided to take such an approach in regard to corporate investment powers.

To limit a corporate credit union to the same investments available to a natural person credit union would significantly hamper the ability of a corporate to meet the needs of its credit union members and might call into question the need for the corporate to exist at all. While recent events have undoubtedly caused some in the credit union movement to question the investment decisions of many corporates and other financial institutions over the last eighteen months, it is absolutely crucial that the agency not overreact by prescribing a "one-size-fits-all" approach to corporate investment powers. Corporate credit unions were not alone in making some investments that were highly rated when purchased but which could not withstand the mortgage and economic meltdown our nation presently finds itself in.

Although certain investment vehicles and instruments may need to be reviewed from a safety and soundness perspective, we do not believe it in the long term best interests of the credit union system for corporate investment authority to be unduly restricted. A more measured approach, in our view, would be for the agency, in conjunction with the implementation of a risk weighted capital system and revised expanded authority standards, to carefully review the investment management capabilities and sophistication levels of individual corporate credit unions. By doing so, corporate credit unions able to demonstrate the competence and ability necessary to fully manage sophisticated investments are not unfairly penalized from providing a valuable service to their member credit unions. Therefore, we would not be supportive of any proposal that would unfairly restrict the ability of a corporate credit union to engage in investment instruments currently permitted in regulation and statute.

Credit Risk Management

For the last several years significant emphasis has been placed on the management of interest rate risk. While warranted and proper, some suggest that the tremendous focus on interest rate risk mitigation may have unintentionally resulted in less sensitivity to the mitigation of credit risk. This ongoing focus on interest rate risk, while important, may have exacerbated the increased reliance on credit ratings for investments. It is important that all levels of risk in a portfolio should be diligently managed and mitigated to extent possible. To that end, any regulatory approach aimed at mitigating risk should not be myopic in its focus and should focus on all aspects of risk.

While the reliability of these ratings may have become more questionable in light of recent events within the financial industry, the necessity for nationally recognized and uniform standards to measure the quality of investments still very much exists. Until an acceptable alternative is identified, continued reliance will be placed on the ratings provided by Nationally Recognized Statistical Rating Organizations (NRSROs). That said, we do see some merit in requiring a corporate credit union to secure more than one rating on a securitized investment from a NRSRO where available.

The ANPR also seeks comment on whether additional stress modeling tools should be required to enhance credit risk management. Clearly, a corporate should take all reasonable measures to adequately manage credit risk. Whether a need exists in regulation for additional stress modeling tools is debatable. There is no question that stress modeling tools can be an effective way to identify and mitigate credit risk, but they can be a costly endeavor that may be duplicative of tools and measures utilized by the rating agencies.

A better approach, in our view, would be to compile a list of best practices for effective risk management that would include among other practices, the use of stress modeling for credit risk. Should the agency determine that stress modeling tools should be mandated in the regulation then we would urge the agency to be flexible and reasonable in the implementation of this requirement and sensitive to the costs and complexities associated with the utilization of such tools.

Like stress modeling, independent evaluations of credit risk in an investment portfolio can be an effective risk mitigation and management tool. However, independent evaluations can also be costly endeavors and may not be warranted for every investment. Therefore, guidance on when and how to use independent evaluations would be beneficial. It would also be helpful if minimum requirements for the independent contractors conducting the evaluations were established to include, among other criteria, minimum experience levels, years in business and industry references. By establishing such standards, it is our view that potential questions regarding the reliability and validity of the independent analysis will be alleviated.

Rather than mandate the use of independent evaluations, our suggestion would be to include scenarios where the use of independent evaluations would be recommended within a compilation of best practices guidelines designed to assist the corporate credit union in the mitigation of risk, including credit risk.

Again, it is debatable as to whether a regulatory mandate for independent evaluation of investment portfolios is preferable to a best practices guidelines approach. However, whether utilized in compliance to a regulatory requirement or adherence to best practices, the corporate credit union and the agency must both be willing to give credence to the ratings provided by the independent analysis.

Asset Liability Management

The widening of credit spreads has caused the agency to contemplate whether it should again implement a previous requirement that corporate credit unions perform net interest income modeling and stress testing. While asset liability management is indeed the most critical component to effective risk management, it is essential that *all* aspects of risk be properly addressed so as to avoid a "managing to the last crisis" mentality that often results in failing to recognize the next crisis.

Again, we believe that the agency and corporate credit unions would be well served if ALM best practices were developed that included the recommendation of modeling and stress testing for net interest income and the testing of credit spread increases. If required by regulation, the mandate should be reasonable, include minimum requirements and should afford corporate credit unions the flexibility to take into account such factors as cost, practicality and overall effectiveness.

Corporate Governance

We wholeheartedly agree with premise outlined in the ANPR that the sophistication and far-reaching impact of corporate activities, combined with the complexities of today's dynamic financial marketplace, absolutely require a governing board with appropriate knowledge, skill and expertise. To that end, we are pleased to offer the following comments on the questions regarding corporate governance posed in the ANPR.

In our opinion, the implementation of minimum standards for corporate board members has merit and should be carefully considered. However, as minimum standards are contemplated, the agency would be wise to consider a broad spectrum of criteria and experiences for potential board members. That is to say, the minimum standards should not rely solely on a potential board member's expertise in financial and accounting matters. While a sound grasp of financial issues is necessary and should be required, these are not the only qualities that make for good board members, in our view. Other factors such as business experience, credit union knowledge, communication skills, integrity and reputation are equally important and should likewise be considered.

We see some advantage in establishing term limits for corporate board members. If properly implemented in conjunction with the establishment of minimum standards for service, term limits can foster innovation, creativity and enhanced oversight among board members and staff. Term limits should be structured in a way to ensure continuity and consistency in the operation of the institution and the board itself. To accomplish this objective, we would suggest that the terms of the board members be staggered with board members being allowed to serve for no more than three consecutive terms.

The ANPR also questions whether directors of corporate boards should include "outside directors" and, if so, should they be allowed to receive compensation for their service. We see some benefit in having a director from outside the credit union community on the board of a corporate credit union. It is likely that such a director will bring a different perspective that could foster enhanced credibility and innovation.

If compensation for directors is authorized it should be for all directors and not just the "outside director." While compensation may be a significant factor in attracting a qualified "outside director," it could also brew conflict and resentment among the other directors if they are prohibited from receiving compensation. It may be that compensation of directors at corporate credit unions is an idea whose time has come and is necessary to attract qualified directors. If so, it should be authorized by the agency. The decision of whether or not to compensate directors, however, should be a decision of an individual corporate credit union.

We agree that a wholesale corporate credit union should be required to have a minimum level of representation on its board from natural person credit unions. Natural person credit unions are the end users of the system supported by the wholesale corporate credit union, its products and its services. The current crisis and the price natural person credit unions are being required to pay to re-capitalize the share insurance fund from balance sheet losses on US Central and corporate balance sheets make a compelling case for a seat at the US Central table. We see that having a seat at the wholesale corporate Board table will give the natural person representative the opportunity to provide meaningful input from a competitive and practical point of view.

The ANPR also poses questions regarding the transparency of executive compensation and the ability to have greater access to salary and benefit information for senior management of corporate credit unions. We believe these questions to be irrelevant and non-germane to the issues associated with corporate restructuring. Executive compensation and greater access to salary and benefit information are not at the heart of the current corporate crisis and are not widely viewed as significant areas of concern for corporate credit unions and their members. Nor is there great interest in having public dissemination of executive compensation at the natural person credit union level. We believe the agency would be better served to focus its efforts on more pressing and substantive issues associated with the function and structure of the corporate system.

We appreciate the opportunity to comment on this advance notice of proposed rulemaking. Recognizing the difficult challenge the agency faces as the safety and soundness regulator for federal credit unions and the insurer of the overwhelming majority of all credit unions, we value your role and public service. Please do not hesitate to contact us if we can be a source of additional information about this comment letter or any other matter.

Sincerely,

Gary Irvin
President and CEO

cc: Chairman Fryzel
Vice Chairman Hood
Board Member Hyland