TO: National Credit Union Administration

FROM: Lonny J. Maurer, President/CEO

SUBJECT: Comments on Advanced Notice of Proposed Rulemaking for Part 704

Payment System

It is our opinion that payment services should be separated from investment services. This may be best accomplished by the use of regional CUSO's chartered for this specific purpose. The CUSO structure should be non-competing, owned by corporate and natural person credit unions that wish to use the services. Governance should be established as a mix of corporate and natural person credit unions who are elected by a democratic process among the natural person credit union users and the corporate system. A balance should be established where a proportionate share of board seats would be from natural person credit unions and corporate credit unions who have ownership in the CUSO.

Liquidity and Liquidity Management

It is fundamental that a core service of the corporate system is to provide natural person credit unions with liquidity services. However, the corporate system also should provide for investment products that are sought by natural person credit unions. A fundamental element of corporate liquidity management is to monitor cash flows and duration so that liquidity needs are met. Forcing corporate credit unions into a short time horizon will not allow them to provide for sufficient opportunities for natural person credit unions.

Corporate credit unions should first be required to provide for liquidity, then investment services. Further, they should be required to monitor the risks associated. Finally, corporate credit unions should only be permitted to invest in AAA rated government backed securities. They should not be allowed to invest in private label investments.

Field of Membership Issues

When first chartered, corporate credit unions had limited geographical charters. NCUA later allowed national charters and fostered competition. We do not believe that competition has provided any positive advantage. Therefore, corporate charters should be reformatted and returned to limited geographical areas. Natural person credit unions should be required to provide tier-two capital in the form of membership capital shares to provide a limited amount of capital to the corporate credit unions. Corporate credit unions would also be required to provide tier-one capital out of their own earnings.

Natural person credit unions that chose to purchase products or services from more than one corporate credit union, assuming they are eligible for membership in more than one, should be required to purchase membership capital shares in each corporate credit union they chose to do business with.

<u>Expanded Investment Authority</u>

Corporate credit unions have provided investment services well for many years. Some corporate credit unions chose to add investments that also brought increased risk to their portfolios. It seems that a simple answer is to require corporate credit unions to maintain capital commensurate with the investment authority they have chosen to pursue. If some corporate credit unions move beyond Base 1 levels of risk, then additional capital should be required.

<u>Structure: two-tiered system</u>

The original design of the two-tiered system is not broken. This system was originally designed to provide pooled resources and cost sharing. This approach was chosen so that natural person credit unions could achieve competitive rates of return on investments. Over time, some corporate credit unions began to compete with U S Central believing that they had the expertise and scale to provide these services without going through U S Central. Because natural person credit unions are a limited market, this competition fostered greater risk taking. It is our feeling that we should return to a model similar to the original where competition is not a contributing risk factor. Limiting the charters of each corporate would require them to focus on quality of products and services, not competing with each other. This model works well for the Federal Reserve System. It would work well for us too.

U S Central has worked well for the corporate system. The network delivered a quality service to natural person credit unions. It provides scale allowing the credit union movement to compete with large brokers and institutions.

As to the question of transfer of risk, it seems apparent that current regulation has not addressed that issue well. Regulations should be developed that control the amount of risk that the corporates and U S Central can take on. The degree to which risk is increased should require additional tier-one capital. This will help to control the amount of riskier investments that are requested to be purchased through U S Central by the corporates or are chosen for purchase by U S Central for its portfolio. It also seems obvious that increased NEV volatility should trigger an increased requirement for capital.

Derivatives and to some extent, private label investments have lead us to the current problem. It is our opinion that these investments should be severely limited or banned outright. If these types of investments are to be permitted, then increased capital should also be required to offset the increased risk of loss.

Corporate Capital

First, it should be noted that the majority of corporate did not deviate from their primary mission and did not add significant risk to their balance sheets. Punishing all for the sins of a few is not the correct answer. Most of the natural person credit unions are fine with the requirements of member capital accounts.

In our opinion, it is very prudent to require increased capital as risk is added to the balance sheet. A capital ratio determined by the certain risk-weighted asset classifications seems to make sense. As balance sheet risk increases, then the amount of core capital should also increase.

If U S Central is retained, then the corporates should not be permitted or chartered to compete with the wholesale entity. If the corporate wish to purchase investments outside the system, that is their option. To make the system work well, the structure should be refined as a system and competition among corporates and U S Central should be eliminated.

The corporates should also be required to maintain capital in U S Central. Doing so encourages them to purchase investments through the system and will encourage the system to work efficiently.

Core Capital

As stated earlier, the current system is not broken. Core capital levels should be increased, especially if a corporate credit union takes on additional risk. Natural person credit unions should be required to maintain member capital shares of a certain level, say one percent of assets in order to use the services of a corporate. If the natural person credit union wishes to use more than one corporate, then they must maintain member capital shares in each one.

Dependent upon the degree of added risk that the corporate pursues, core capital should be required to increase. For example, tier one capital consisting of undivided earnings and retained earnings should be set at 4% and should be retained for a low risk corporate. As the defined risk level increases, the corporate must increase tier-one capital. Obviously, requiring the corporates to increase tier-one capital quickly to 4% would create a hardship. Therefore, they should be permitted to increase capital over a period of time, say five to eight years.

Tier-two capital funding and maintenance does need some change. In period such as the current, natural person credit unions should be permitted to pay in additionally required member capital shares over time, especially after impairment occurs. When a natural person credit union first joins a corporate, it should also be allowed to pay in the required amount over time. This would ensure that liquidity does not present a problem for the natural person credit at any time where additional deposits are required.

Credit Risk Management

The current system provides for directors to come from within the ranks of natural person credit unions. The requirements to serve as a director of a corporate credit union should be established such that certain minimum requirements are met. For example, requiring that a director come from a successfully managed credit union of a minimum asset size, with a CAMEL rating of two or better and with a minimum of at least five years of credit union management could be a place to start. Requiring directors to come from outside of the credit union system is not desirable. Term limits should not be imposed. The credit unions that use the corporate can police themselves and use the power of the vote to remove unwanted directors.