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VOLUNTEER
CORPORATE
CREDIT UNION

March 31, 2009

The Honorable Michael E. Fryzel
Chairman, National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

The Honorable Rodney E. Hood
Vice Chairman, National Credit Union Administration

The Honorable Gigi Hyland
Board Member, National Credit Union Administration

RE: Comments on Advanced Notice of Proposed Rulemaking for 12 CFR Part 704

Chairman Fryzel, Vice Chairman Hood, and Board Member Hyland:

On behalf of its Board of Directors and Chief Executive Officer, Volunteer Corporate Credit Union (VolCorp) appreciates the opportunity to comment on the ANPR.

Background

VolCorp was formed in 1981 as a member-owned cooperative for the purpose of providing services to credit unions that did not have the capabilities to produce them or that could be provided more efficiently on a collaborative basis. A member-owned cooperative structure also afforded members the ability to exercise effective control over VolCorp's decision making and to determine its strategic direction, resulting in a much more focused and reliable source of services.

Over its 28 year history, VolCorp has not wavered from its mission and is relied upon by its members for dozens of critical services. It would be very time consuming and expensive to find replacement providers for these services, not to mention the loss of control. VolCorp members value VolCorp very highly and do not desire to see any significant decrease in the services VolCorp offers or to lose their control over its operation.

The current severe economic climate has obviously exposed weaknesses in corporate oversight and more stringent regulation is definitely needed to prevent reoccurrences. Economic recessions always increase losses at financial institutions, which should be expected. It should also be expected, however, that financial institutions should be prepared to survive those losses. They should have both the capital and controls in place to absorb losses generated by the inevitable economic recessions that occur with regularity in this country, even accounting for the fact that some recessions are more severe than others.

2460 Atrium Way
Nashville, TN 37214
www.volcorp.org
www.volcorpdesign.org
VolCorp & You!
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(615) 232-7900
(800) 470-3444
Main Fax: (615) 232-7999
IP Fax: (615) 232-7979

Obviously, the corporate network was not prepared to survive the current economic downturn. The fault lies with the severe undercapitalization that existed within corporates, especially at U.S. Central. The 1%-2% retained earnings requirement was woefully inadequate. Also, because of the extremely low capital requirements afforded corporates, those corporates that had excess capital chose to leverage up, which exacerbated the situation even further.

Solutions for the problems of the corporate network should primarily focus on the causes of those problems: undercapitalization and too much debt. Unfortunately, in the short term corporates will not have enough retained earnings to provide anywhere near the capital that will be needed. Natural person credit unions will have to step up if they want to preserve their corporates. In return for their increased investment, natural person credit unions deserve to have new controls put into place that adequately protect them.

The Role of Corporates in the Credit Union System

<u>Payment System</u>

The issue of whether to isolate payment system services from other services should depend upon how aggressive the corporate manages its balance sheet. The risks are very minimal if the corporate manages its investments conservatively, maintains adequate cash, and does not leverage up with excessive amounts of debt. The experiences of corporates in the current economic downturn illustrate this point very clearly. VolCorp, which has very little debt, has had absolutely no problems with liquidity or settlements during this period. Yet other corporates, primarily those who had leveraged up, have experienced a liquidity crises and the NCUA had to step in to ensure payment settlements with the TCCULGP and CU SIP programs.

Recommendation: Amend regulations to strengthen requirements for debt, liquidity, and cash flow in order for a corporate to include payment services among its service offerings. If the corporate wishes to operate outside these requirements then require a legal and operational firewall be established to assure that funds are available for settlement and are not comingled with other funding needs. We disagree with the proposal for separate charters as that would instigate an undue hardship upon credit unions and significantly dilute the efficiencies of the corporate system.

<u>Liquidity and Liquidity Management</u>

The liquidity services provided by corporates are very important to its members and should be maintained as a core service. Many credit unions rely solely on their corporate for liquidity solutions. Recent events, however, underscore the need for additional controls to make sure that funds will be available when needed. Large amounts of debt and little liquidity at some corporates have compromised their ability to provide adequate liquidity services to their members.

Recommendation: The suggested remedy for this area is very closely associated with what was recommended for the payment system. Strengthened requirements for debt, liquidity, and cash flow are definitely warranted. Limitations on borrowing should be substantially tightened and liquidity standards for cash and short term investments should be quantified.

Field of Membership Issues

It is difficult to comprehend that national fields of membership led to excess risk taking when you consider that most financial institutions, including natural person credit unions, are in a much more competitive arena than are corporate credit unions. Also, it should be noted that non-competitive financial institutions, such as the Federal Home Loan Banks, also suffered that same fate. The real issue regarding field of membership, we believe, is that some corporates have grown to become "too big to fail".

Recommendation: No changes

Expanded Investment Authority

The expanded investment authorities granted to corporates did little to contribute to the current problems. Indeed, corporates did not stray from the conservative end of their authority and could have invested in securities with a lot more risk and still been in compliance. A lack of capital is the real culprit. Therefore, expanded authority should be accompanied with expanded capital requirements, to reflect the increase in risk.

Recommendations: Establish increased capital requirements commensurate with the increase in risk associated with the expanded authority. Increase the minimum credit rating permissible to A from BBB.

Structure; Two-Tiered System

The recent losses experienced by U.S. Central and the subsequent elimination of their retained earnings strongly suggest a much reduced role for them in the future. Other than the losses stemming from their investment portfolio, which were directly related to their term investment program, U.S. Central provides very valuable services to the credit union system and they should be allowed to continue to do so.

Recommendation: The term investment role of the wholesale corporate should be eliminated, thereby greatly reducing their assets and the associated risk. Borrowing should be restricted to short term liquidity needs. Other than that, they should be granted the same powers and authorities that retail corporates have, adjusted for the other recommended changes listed in this document.

Corporate Capital

Core Capital

Considering recent events, requiring more core capital of corporates is crucial to maintaining solvency of the corporate network. Capital inadequacy was the major reason why the NCUA had to step in to bailout U.S. Central. The problem is that corporates have lost much of their retained earnings and the majority of core capital will have to come directly from natural person credit unions, putting them at much greater risk. Corporates will need to rebuild retained earnings as quickly as they are able.

Recommendation: The minimum core capital ratio requirement for corporates should be gradually increased to 6% over a five-year period, with yearly goals established. Define membership capital as core capital. Due to the fluctuations in corporate assets, the current 12-month moving daily net assets should continue to be used as the denominator. A minimum retained earnings ratio should also be continued, but allowances for current losses will need to be made, perhaps raising the required ratio to 3% over the five-year period. Corporates that cannot meet minimum capital requirements should be placed on probation and those that do not achieve compliance within twelve months should be liquidated or merged.

<u>Membership Capital</u>

There seems to be no rational reason to maintain membership capital, especially if core capital is required for service. Also, the rating agencies do not consider membership capital as real capital. It's a fossil of the past that needs to be eliminated, but it would be extremely difficult in today's environment for natural person credit unions to agree to increase their commitment to their corporate.

Recommendation: For the time being, keep membership capital as the primary capital of corporates and over time convert as much of it to core capital as possible by eliminating the withdrawal provision.

<u>Risk-Based Capital and Contributed Capital Requirements</u>

Risk-based capital should be considered for corporates. It is the international standard for measuring capital adequacy and there is no logical reason for corporate credit unions to be excluded. Given the current economic situation, however, there is no reasonable way for corporates to come into compliance anytime soon. Considering the very low amounts of retained earnings at corporates, it also cannot be achieved without contributed capital from natural person credit unions

Recommendation: Risk-based capital should be required for corporates within five years, allowing for a build-up period. Natural person credit unions should not be required to maintain a contributed capital account as a prerequisite to obtaining services from the corporate until the system returns to more normal times.

Permissible Investments

If corporates can demonstrate that they have the necessary expertise, capital, and controls in place, they should be allowed to keep their current investment authorities. It allows them to be competitive with banks and brokers. Natural person credit unions have benefited greatly from corporate investment capabilities in the past. The more risky securities that have caused a lot of the current market losses should be excluded from that authority.

Recommendation: Prohibit CDO's, NIM's and subprime and Alt-A asset-backed securities, otherwise, leave corporate permissible investments as they are.

Credit Risk Management

Nobody really predicted the mortgage loan mess in advance of it happening. Reliance on internal credit evaluations is limited in its protection value and corporates shouldn't be made to waste significant sums of money trying to do so. Some tightening up on credit risk management is warranted, however, and regular independent evaluations offer the most protection since internal analysis was done on the initial purchase.

Recommendation: Require two rating agencies be used and that both meet the minimum rating requirement. Corporates should also be required to obtain independent evaluations of the credit risk in their portfolios on a semi-monthly basis from qualified firms.

Asset Liability Management

Corporates operate with such small net interest margins and profitability that it is crucial that they have a good indication of what their net interest income is going to be in the future and what the impact will be of a range of interest rate scenarios.

Recommendation: Require that corporates perform net interest modeling and testing on a monthly basis.

Corporate Governance

Corporate governance is very important, but history teaches us that even the finest financial minds can be caught unaware. The large investment and commercial banks had some of the most qualified board members in the country, but even they did not anticipate the current problems of those institutions.

Recommendation: No changes to current governance structure, except at the wholesale level, where a majority of Board members should be natural person credit union CEO's who are also Board members of a retail corporate.

Sincerely,

Albert P. Veach

Albert P. Veach
President/CEO
Volunteer Corporate Credit Union