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Redwood Credit Union

April 6, 2009

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

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

Dear Ms. Rupp:

Redwood Credit Union (RCU) appreciates the opportunity to respond to the Advanced Notice of Proposed Rulemaking for Part 704 (ANPR). The comments contained herein address several critical issues stemming from the consequences of NCUA's recent actions on WesCorp and U.S. Central, as well as our views on certain questions posed in the ANPR.

Overview

NCUA's ANPR seeks input from all stakeholders in the credit union industry regarding reforms to the regulatory and functional structure of the corporate system. It is a broad reconsideration of the current role corporate credit unions play in the credit union system, including their charters, powers, investment authority, capital requirements, fields of membership, risk management and governance. While recent events justify the need to re-assess the corporate credit union (CCU) system, we believe this exercise should be performed for the purpose of identifying lessons learned and applying appropriate changes in order to build a more resilient CCU system. We would strongly disagree with any effort to use the ANPR process as a means of wholesale remaking of the CCU system or disbanding it all together.

The following key points are distilled from the following sections of our comments:

1. NCUA should restore at least some of member equity for WesCorp.
2. NCUA needs to share the PIMCO report with credit unions.
3. CCU's should be allowed to maintain their current role with respect to payment systems, liquidity, and investments, albeit with fewer CCU's and elimination of US Central.
4. CCU's need to implement sophisticated and transparent credit risk management practices, in addition to more transparent asset-liability management practices.
5. NCUA should increase minimum risk-based capital requirements for CCU's.

6. NCUA must seek every means possible to reduce the extremely onerous financial impacts that CCU stabilization efforts are having on natural person credit unions (NPCU's).
7. NCUA must seek more than $6 billion from Treasury for the proposed CCU Stabilization Fund.

Conservatorship of WesCorp and US Central

The impact of NCUA taking conservatorship of WesCorp on RCU is a loss of $10 million (56 basis points of assets) on our MCA and PIC shares. We strongly encourage NCUA to determine a regulatory or legislative solution that restores some or all of the member equity at WesCorp. Credit union members of WesCorp deserve to have a degree of membership/ownership interest, and should have provided to them by NCUA the Agency's planned path to WesCorp's recovery and return to member ownership and control. AIG, BAC, Citigroup and others were technically insolvent and bailed out by the government, yet their shareholders were left with some, albeit significantly impaired, equity. We believe that a similar type of solution for credit unions should be explored. Such a move would go a long way towards restoring credit unions' sense of ownership, responsibility, and having a voice in WesCorp's future.

While we are deeply concerned about the NCUA's actions with respect to WesCorp, we would like to reassure NCUA that we will actively support the new CEO of WesCorp and we will continue to be a vocal supporter of maintaining current deposit levels in the CCU system.

We would also like to comment regarding NCUA's use of and reliance on Pacific Investment Management Company (PIMCO) and its analysis of the residential mortgage backed securities (RMBS) held by corporates. Before committing almost $6 billion to replenish the share insurance fund, not to mention impairments of credit union capital deposits in corporate credit unions, credit union owners of WesCorp and US Central deserve very detailed information on the assumptions, methodology, and results of the PIMCO study in order to better understand the calculation of the cost estimates, and to determine whether the agency's cost estimates of the losses for the corporates are reasonable and justified. To date NCUA has provided credit unions little information about the PIMCO report, and absolutely no details from it. Further, we are gravely concerned about the apparent conflict of interest between PIMCO's role as analyst of corporates' portfolios and their publicly stated intention to purchase legacy/toxic assets under the Treasury's Public-Private Investment Program. If true, we believe that NCUA should reevaluate PIMCO's current loss estimates for the corporates, as well as discontinue any further reliance on the company's analysis regarding this issue. At that point, the NCUA Board should work on devising a plan for credit unions to pay for the actual losses that may result from corporate investments as they occur, rather than requiring credit unions to pay up-front based on a theoretical estimate of the costs.

NPCUSIF Impairment and Corporate Credit Union Stabilization Fund

The impact of the NPCUSIF impairment and additional assessment on RCU is a loss of $13 million (72 basis points of assets). While we consider the proposed legislation to create a CCU Stabilization Fund with an accompanying 7-year pay-back period to be a very positive development, we are nevertheless concerned that the current $6 billion requested funding amount will not be enough. Credit unions have been working with members of Congress to urge the Treasury to set aside at least $20 billion of TARP funds to be accessed should corporate or natural person credit union losses covered by the NPCUSIF exceed $500 million. By allowing NCUA to reduce the current cost to credit unions of the corporate stabilization plan, this action would greatly mitigate the negative impact on credit unions' ROA and net worth and would bolster both credit union system confidence and public confidence.

Role and Structure of Corporate Credit Unions

RCU believes that CCU's play a vital role for credit unions. By serving as a central point for credit union investment and payment system services and aggregation, they provide many services that typically would be economically available only to the largest financial institutions (e.g., share draft processing, wire transfers, ACH services, cash orders, etc.). By managing liquidity within the credit union industry, CCU's are able to effectively and efficiently move excess liquidity to the areas of greatest need. In addition, they provide the wherewithal to help credit unions manage risk, and are uniquely positioned to facilitate participation lending. Operational efficiencies and cost considerations prohibit many credit unions from obtaining these services directly from the Federal Reserve.

Without CCU's, many credit unions would be largely dependent on more than one bank or bank-affiliated institution for these services, which would no doubt add significant additional costs and due diligence burdens to credit unions' operations, which would ultimately be passed on to members in the form of lower dividends or higher loan rates. We are reminded of the processing relationship (i.e., item processing, shared branching, and ATMs) that California credit unions had with Security Pacific Bank several years ago. When Security Pacific was merged with Bank of America, that relationship was severed by the bank over a six month period, which would have lead to widespread dislocation and service collapse for California credit unions if WesCorp had not stepped in to pick up the item processing business and been instrumental in creating the business plan for Financial Service Centers Cooperatives (FSCC). CCU's have long maintained a necessary and trusted relationship with credit unions. Therefore, we strongly disagree with any action which would substantially alter the fundamental role and functions of the current corporate system.

We disagree with NCUA's contemplation to establish separate charters for payment system services and investments, as well as a return to defined fields of membership. We believe such a move would be anti-competitive and would hamstring the viability of the corporate system, likely leading to future problems requiring intervention by NCUA and/or natural person credit unions. Furthermore, not every corporate offers a full array of services (e.g., item-processing for imaged items). Restricting corporate usage to geographic fields of membership would unfairly and unsafely restrict credit unions from accessing critical corporate services.

Along the same lines, we feel that a requirement that an "outside director" be from entirely outside the credit union industry would be potentially damaging, and could serve to weaken the unique nature and philosophy of credit unions (and, frankly, we believe that such a requirement would not have prevented current circumstances). However, we are of the opinion that term limits for directors would be reasonable, as would minimum standards for experience, knowledge, and training.

Finally, we would support elimination of U.S. Central since we view it as an unnecessary and not very transparent layer of the CCU system.

Risk Management

It is conventional wisdom that WesCorp and U.S. Central unknowingly took on too much credit risk in their investment portfolios. Time will tell if this really true. In the meantime, we encourage NCUA to turn away from the temptation to force CCU's to avoid credit risk in the future by taking away or severely curtailing their investment capabilities. Rather, NCUA should ensure that CCU's are much more adept and transparent at credit risk management.

A complete autopsy of the risk quantification and decision-making process needs to be completed. Our speculation is that you will find two major problems: (1) insufficient tools and framework for credit risk management, and (2) flaws in the assumptions and judgment of decision makers.

Lessons learned should then be applied to risk management practices and regulation. We believe there will be a very positive outcome of getting the risk management process right, in that it will allow CCU's to remain the investment vehicle of choice for most NPCU's. We believe this is preferable to a scenario whereby NPCU's invest outside of the CCU system, and end up taking on losses from myriad investment vehicles.

Capital

Recent events indicate that corporates require a larger capital cushion. Accordingly, we support raising the minimum capital levels of the CCU's, along with accompanying risk-based capital requirements and redefining primary capital as retained earnings only.

We also encourage NCUA to modernize the PCA system for NPCU's. Such efforts may include urging Congress to consider the removal of all of the PCA stipulations from the statute and leave it to regulatory determination, similar to the system under which the banking industry operates. This would provide for greater flexibility and responsiveness, especially during times of crisis. Credit unions, which have proven to be less risky financial intermediaries than banks and thrifts, should be subject to a PCA framework that provides, at minimum, as much flexibility as the FDIC, the OTS, and the OCC utilize for bank PCA standards.

We also encourage the NCUA Board to support changes to the definition of net worth that would allow government assistance in the form of loans to credit unions to be included in a credit unions net worth ratio. Such loans, in the form of "Section 208" assistance, were used effectively in the 1980s to help a number of credit unions through a severe economic crisis. These credit unions are now healthy, and they are providing valuable services to hundreds of thousands of members. The loans that were used to help these credit unions were repaid, with interest.

RCU believes that the NCUA should utilize its regulatory authority to redefine the definition of "total assets" under §702.2(g) of the Prompt Corrective Action rule to exclude guaranteed or low/no-risk assets from net worth ratio calculations. This action would provide immediate relief in the following ways:

- It would allow NPCU's to invest in no-risk assets and/or take certain assistance (e.g., loans from the CLF, asset purchase, guarantees, etc.), if necessary, without harming or diluting their net worth ratio.
- It would give many NPCU's time to manage the multitude of challenging issues they currently face due to this once-in-a-lifetime economic crisis—which now includes the costs of the stabilization plan—without running afoul of PCA requirements.
- It would encourage additional NPCU participation in the CU SIP program, therefore generating additional liquidity for the corporate system.

We applaud the NCUA for issuing guidance to examiners which includes instructions to recognize and allow for temporary reductions in ROA and net worth that result from credit union participation in the CU SIP program, and for recently taking action to amend its rule on the assessment of the federal credit union operating fee to exclude investments made under the CU SIP and CU HARP programs from the calculation of total assets. However, we believe it would provide more uniformity and reliability to formally make this redefinition via an amendment to the PCA regulation.

Liquidity

We are encouraged by reports of the success of the CU SIP program in providing liquidity to CCU's, which has allowed them to reduce their borrowings. As recommended in the January 2009 report from PricewaterhouseCoopers LLC to the NCUA Board, the CLF should be used to infuse liquidity and capital into the CCU's. A change to the Federal Credit Union Act would expand authority of the CLF beyond its current authority to make liquidity loans only to natural person credit unions to permit direct investment in corporates.

Closing

We believe that while the corporate system is in need of some key adjustments, it is not broken. External factors are what caused the current crisis, not the corporate system structure. Going forward, our credit unions would like to be reassured that NCUA will maintain an ongoing evaluation as to the possible need to continue the corporate deposit guarantee past 2010, and that the Agency is prepared to address the current maturities of CU SIP investments.

In closing, RCU thanks the NCUA Board for the opportunity to provide the views, concerns, and recommendations of natural person credit unions on the Agency's unprecedented action. We cannot emphasize enough how critical it is that the Board seriously consider these views, which come from many of the credit unions hardest-hit by NCUA's actions. We urge the Board to act to strike an effective and fair balance between the current needs of the corporate system and the very real, long-term, substantial needs of the entire credit union movement, and to strive for cooperation and transparency with credit unions in the process. We believe that to not do so will ultimately hurt public confidence in credit unions and the NCUA, and will be financially detrimental to U.S. consumers.

Sincerely,

Brett Martinez

Brett Martinez
President & CEO
Redwood Credit Union
Santa Rosa, CA