EasCorp
What together we can do.®

April 1, 2009

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

Dear Ms. Rupp:

RE: Advance Notice of Proposed Rulemaking (ANPR) for Part 704

On behalf of the management and Board of EasCorp, I thank you for the opportunity to comment on the NCUA's Advance Notice of Proposed Rulemaking.

Before we address the questions presented in the ANPR, we would like to provide some background about corporate credit unions and to describe how EasCorp has positioned itself to provide value for members despite the recent downturn in the financial services industry.

Corporate credit unions, commonly referred to as "corporate," are credit unions that provide services for natural person credit unions (NPCUs). Like other credit unions, corporates are not-for-profit, cooperative financial institutions that are owned and directed by their members. Historically, the role of corporates has been to manage liquidity efficiently for credit unions. The deregulation of financial services in the early 1980s allowed corporates to offer additional services to credit unions, often at a significant cost savings compared to other types of providers. Today, corporates' members benefit from the cost savings and synergies created through economies of scale and expanded access to innovative products and services. As corporates continue to provide affordable liquidity, investment and payment services to their members, they empower retail credit unions to remain competitive in today's financial services marketplace.

U.S. Central Federal Credit Union (U.S. Central) serves as the corporate credit union for the corporates. Like other corporates, U.S. Central provides its members with liquidity, investment and payment services at reasonable rates. U.S. Central has experienced a significant economic setback as a result of extensive investments in mortgage- and asset-backed securities. As a result of these massive unrealized losses, in January 2009 the National Credit Union Administration (NCUA) injected $1 billion of new capital into U.S. Central from the National Credit Union Share Insurance Fund (NCUSIF) to prevent further erosion of confidence in the corporate network.[1] After conducting stress testing, on March 20, 2009, NCUA placed U.S. Central and WesCorp (another corporate) into conservatorship after concluding they held an unacceptably high concentration of risk in mortgage- and asset-backed securities.[2]

EasCorp's Mission

EasCorp was formed in 1978 by individuals who believed in the value added by a credit union that serves other credit unions. Our mission statement is "To support credit unions in ways that enable consumers to rely on them for all their financial services needs." Throughout our history EasCorp has provided members with access to cutting-edge, value-added products and services, including specialized payment systems and superior performance on overnight and term investments. For example, EasCorp was the first corporate in the country to offer several specialized services, including electronic check imaging, an interactive cash management workstation (EasCorp Online), and statement-rendering services (including production of delivery of electronic statements to natural person members). We have been committed to fulfilling this mission by providing our members with a broad range of services that are offered from a solid foundation of safety and soundness.

Today, EasCorp holds over $1.1 billion in assets and maintains a low-risk, highly-liquid marketable securities portfolio, with over 98% of our holdings in AAA rated securities. We face minimal exposure to potential securities write-downs related to the recent economic downturn. We have stayed the course that was charted thirty years ago, maintained conservative investment policies, and resisted the temptation to chase higher interest rates attached to riskier investments.

EasCorp remains committed to being the primary source of liquidity for our members and maintaining appropriate capital and retained earnings to meet anticipated needs. We maintain adequate liquidity in the form of overnight deposits at numerous depositories and through access to the Federal Reserve Bank's Primary Credit Programs and other lines of credit.

Temporary Corporate Credit Union Share Guarantee Program (TCCUSGP)

In February, EasCorp declined an opportunity to participate in the TCCUSGP offered by the NCUA.[3] The program offered participating corporates a temporary guarantee on all shares (excluding paid-in capital and membership capital), in exchange for compliance with the conditions set forth in a Letter of Agreement. This was a difficult choice to make, but it was made in accordance with our commitment to do what is in the best interests of our members.

[1] Impact of the Corporate Stabilization Actions on the NCUSIF, available at http://www.ncua.gov/CoporateStabilizationProgram/ImpactoftheCorporateStabilizationontheNCUSIF_2-13.doc.

[2] Media Release – NCUA Board Meeting Agenda Modified, available at http://www.ncua.gov/news/press_releases/2009/MR09-0320.htm.

[3] Temporary Corporate Credit Union Share Guarantee Program, available at http://www.ncua.gov/letters/2009/CU/Enclosure_2TemporaryCorporateShareGuaranteeProgram.pdf.

We declined the guarantee for several reasons. Based on the information available to us at the time, we decided that passing up the guarantee, and declining to sign the compulsory written agreement with NCUA that was tied to it, was the only way to protect our capital and retained earnings, generated through years of member loyalty, from potential seizure in an industry-wide reorganization to offset losses by other corporates. We felt it necessary to take these actions to protect EasCorp from being swallowed by the systemic risk attributable to other corporates.

EasCorp's Achilles' heel has been its faith in U.S. Central. As we will discuss, several aspects of U.S. Central's governance and policies have contributed to large write-downs, to which EasCorp was materially exposed. Apart from the effect of having capital accounts at U.S. Central, EasCorp would be very strong today. We strongly believe that our conservative investment program and focus of delivering services to our members well positioned us to navigate future financial challenges without having to participate in the guarantee program.

Although we are not participating in the TCCUSGP, we have extended further assurances to our members to demonstrate our strong position in the current economic climate. We have offered our members the opportunity to obtain the benefit of a deposit guarantee by investing through us with US Central. We have self-imposed specific substantive operating limitations consistent with those that a written regulatory agreement would have imposed on us, including a prohibition on paying bonuses to our senior officers, a restriction on any new activities under expanded investment authorities, and a restriction on loans to or investments in credit union service organizations (CUSOs).

Response to ANPR

We offer the following comments in response to the questions presented in the ANPR.

Fields of Membership

We recommend retaining national fields of membership for several reasons.

EasCorp believes that restricting a corporate’s ability to work with prospective members due to geographical barriers is an unwise, anti-competitive policy that will decrease the competitiveness of corporates versus other service providers to Natural Person Credit Unions (NPCUs), and elevate, rather than decrease, challenges faced by corporates. Limiting corporates to particular regions will decrease innovation in services provided and dampen the growth that is possible in an open marketplace of ideas. NPCUs are not limited in their selection of non-credit union service providers, and it has become common for NPCUs to use more than one corporate because some corporates have begun specializing in certain products. There is no evidence that suggests that a national field of membership has been a cause of the financial difficulties facing many corporates. Indeed, state-chartered corporate credit unions have operated under national fields of membership for decades. The recent financial troubles that some of these institutions are undergoing are unrelated to their national fields of membership. Instead, we believe they are primarily attributable to investments that have gone sour.

EasCorp was granted a national field of membership in 1998. By abiding by our commitment to providing our members with a high standard of safety and soundness, we have met the challenges of the recent economic downturn and continue to serve our members across the country.

Permissible Investments

Corporates may purchase and hold a greater variety of investments than NPCUs, particularly under expanded investment authority provided by Part 704. According to the ANPR, the NCUA is considering whether to constrain or restrict the investment authorities of corporates.

EasCorp believes that corporates should retain the ability to hold a broader scope of investments than NPCUs because retail and corporate credit unions have different investment and liquidity needs. To provide liquidity for its members, a corporate requires access to a wide range of short-term investment opportunities with the flexibility to make alternative investment decisions that might be unreasonable for a NPCU to make.

Historically, EasCorp has maintained a conservative investment strategy. Nonetheless, in order to provide liquidity to our members, we may seek to invest in areas traditionally beyond the authority of NPCUs. Our experience in analyzing and dealing with complex securities allows us to make these types of investments with confidence. Therefore, we believe the choice to invest in certain investment opportunities traditionally restricted from NPCUs should be left to the corporate and its Board within existing regulatory parameters applicable to corporates.

Given the conservative, liquidity-based nature of corporates, it seems prudent for corporates not to invest in complex, exotic security structures such as collateralized debt obligations or net interest margin securities. These securities require the purchaser to understand the underlying collateral as well as the complex structure of the notes issued, and oftentimes corporate officials have had little to no experience with these types of instruments.

However, we believe investments in subprime and Alt-A asset-backed securities should remain permissible. The structure of these securities typically follows that of a senior-subordinate tranche; a long-established issuance structure that many corporates have become familiar with. Also, the underlying collateral typically consists of traditional consumer loans for which comparable industry data is readily available. Nonetheless, regulations should limit the extent of exposure to these types of assets, based on collateral characteristics and on priority in the payment waterfall, i.e., additional risk should not be taken on by investing in subordinate tranches.

Credit Risk Management

The NCUA is considering whether to decrease the extent to which a corporate may rely on credit ratings provided by Nationally Recognized Statistical Rating Organizations (NRSROs). We believe the current credit ratings system is flawed and requires prompt regulatory changes.

Accuracy of NRSRO Ratings

At present, all debt instruments purchased by a corporate must have a credit rating from at least one NRSRO.[4] These ratings provide an opinion as to the creditworthiness of the obligor or the obligor's security. However, we believe credit ratings do not provide a complete picture of the risk associated with a particular investment. Ratings agencies have recently been criticized for the accuracy of their ratings, the breadth of stress-testing undertaken to determine ratings, and the frequency of their model and ratings updates. Although ratings are useful ways to compare securities and their potential performance, we believe they should only constitute one factor in a corporate's overall investment decision.

Multiple Ratings

Oftentimes, a corporate may decide to use multiple rating agencies when analyzing prospective investments, creating an opportunity to "cherry pick" the best ratings in order to invest in otherwise questionable securities.[5] We believe the regulations should encourage credit analysis that takes ratings into account, but demand more than a "paint by number" approach. Accordingly, we propose the NCUA require more than one rating for an investment. Well-structured securities from established issues are rarely issued with just one rating, and multiple ratings may offer complementary external perspectives on a security that can assist with internal analysis and monitoring operations. We believe the lowest NRSRO ratings available should meet the minimum rating requirements under the regulations.

Stress Modeling

Additional credit stress modeling would enhance the credit risk management process, but this tool may only lead to modest gains. Experience has shown that current industry credit stress modeling is limited to mortgage-related securities, while the availability of modeling for other consumer-backed credit receivables (such as auto and credit cards) is much more limited. Modeling is also costly, as it requires software purchases and other expenditures, or the payment of service fees to an outside vendor.

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[4] 12 C.F.R. §704.6 (2009).

[5] NCUA Corporate Examiner's Guide at 201-24, available at http://www.ncua.gov/corporatecu/corpexguide/corpexguide.html.

Concentration Limits

The current regulations set credit limits as a percentage of capital, and suggest that corporates limit concentrations of credit risk by diversifying with regards to the originator of receivables, insurer, industry type, sector type, and geographic distribution. We believe that limitations based on the obligor, collateral type and sector type should remain in force. Furthermore, non-agency limitations should be expanded to include the type of underlying collateral, e.g. prime, Alt-A, interest-only loans, etc. Overall, greater emphasis should be placed on the ongoing monitoring of underlying collateral performance, servicer ratings, and industry trends.

EasCorp's Credit Risk Management Strategy

EasCorp has not encountered significant issues attributable to the imperfect nature of the NRSRO ratings system because we do not make investment decisions based on ratings alone. Instead, we undertake extensive analysis of prospective purchases to form an independent judgment on the creditworthiness of a particular security before making an investment.

We recognize that NRSRO ratings often do not convey the full picture regarding the risk of certain investments, particularly complex securities. Many investments in AAA-rated securities, including asset-backed securities, have been greatly affected by the recent economic downturn. All corporates would benefit from changes in the ratings system that would provide additional transparency beyond the current NRSRO ratings. Unless ratings can provide additional insight, many corporates may accept unexpected levels of risk by taking capital measures absent a working credit risk system.

Expanded Investment Authority

Corporates may invest in lower-rated securities (down to BBB-rated) under expanded investment authority granted by the NCUA.[6] Corporates are required to satisfy several requirements for this authority, including adopting capital, management, and infrastructure protections and expanded Net Economic Value (NEV) guidelines.[7] For example, participating corporates must utilize a credit analyst and an internal auditor, and adopt a clear separation of duties.[8] Nonetheless, despite these mandatory protections, the most vulnerable corporates today have participated in expanded investment authority. Additionally, the current regulation does not address the credit implications of going down the credit curve with regards to tighter limitations on issuer names, collateral types, and sectors.

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[6] 12 C.F.R. §704, Appendix B (2009).

[7] U.S. General Accounting Office, Corporate Credit Unions: Competitive Environment May Stress Financial Condition, Posing Challenges for NCUA Oversight 24 (2004).

[8] Id.

In general, expanded investment authority has not been successful, and at worst, it has led to significant financial distress. The regulations should be revised to address the added credit risk the corporate is assuming through more stringent credit limits and credit modeling requirements. We believe the regulations should require additional oversight and monitoring of investment decisions within expanded investment authority. This issue may also be addressed by adopting more stringent credit risk management procedures, as previously discussed.

Periodic Requalification

We believe corporates should be required to satisfy periodic requalification for expanded investment authority in conjunction with each examination administered by the Office of Corporate Credit Unions. This requirement should be adopted immediately, and not as the by-product of future regulatory amendments.

EasCorp operates within Base-Plus investment authority, which allows us additional flexibility when conducting stress tests under Part 704.8.[9] We have not purchased lower-rated securities or made riskier investments under this expanded authority.

Core Capital

Retained Earnings and Paid-In Capital

Retained earnings are the total of the corporate credit union's undivided earnings, reserves and any other appropriations designated by management or regulatory authorities. They are the most permanent and primary form of corporates' capital because they are generated within the credit union. Paid-in capital (PIC) is a perpetual, non-cumulative dividend account that is available to cover losses exceeding retained earnings. However, PIC is not insured by the NCUSIF or other insurers and cannot be pledged against borrowings. Prior to July 2003, PIC was defined as a member deposit account with an initial maturity of at least 20 years.[10] NCUA has stated that PIC should not be used for extended periods, and instead should be used as a bridge during temporary periods of stress.[11]

Calculations of Core Capital Ratios

Core capital ratios are calculated by dividing core capital (retained earnings plus paid-in capital) by moving daily average of net assets (DANA) for the month being measured and the previous 11 months. This 12 month rolling average was intended to smooth out the peaks and valleys associated with providing liquidity and other services to member credit unions. However, rolling

[9] 12 C.F.R. §704, Appendix B (2009).

[10] GAO at 16.

[11] GAO at 16.

averages are lagging indicators of core capital ratios when balances are shrinking, and may make a corporate's financial situation look worse than it actually is. We suggest that the regulations apply a modified rolling average that uses a 3 month time frame, in order to avoid the downsides associated with a longer evaluation period.

Flexible Approaches to Core Capital Ratios

We believe the regulations should recognize that there cannot be a one size fits all approach to core capital ratios, because it would be inefficient to require all corporates to satisfy ratios based upon a fixed percentage of their balance sheets. Although such an approach might protect against financial risks attributable to overleveraging, it would ignore the diverse ways that corporates' undertake operational risks and decision making procedures. Many activities are not reflected on balance sheets, and similarly sized corporates often have very different risk profiles. It would be an oversimplification to require compliance with one standardized ratio across the entire industry based upon a cursory examination of the balance sheet.

Timeframe For Compliance

Finally, we suggest that any new required ratios provide a time period during which corporates may raise capital to meet those requirements, given the after effects of write-downs associated with U.S. Central's recent troubles. Given the state of the current financial industry, we believe it would be fair to require corporates to meet a new capital requirement by the end of 2010.

Membership Capital

Membership capital shares are funds contributed by members that hold a primary membership in a corporate. These shares have a 3-year minimum withdrawal notice, or are term certificates with a minimum term of 3 years. They are available to cover losses that exceed retained earnings and PIC, but are not insured by the NCUSIF and cannot be pledged against borrowings.[12] In many ways, membership capital resembles a form of subordinated debt that may protect the insurance fund in the event of a corporate failure.[13]

EasCorp has actively sought to increase its retained earnings in lieu of relying on membership capital. By purchasing a membership capital share, members make a long-term commitment to the corporate. This act strengthens the corporate's balance sheet, increasing their opportunities to sell secondary capital and to present more favorable ratios. However, we believe that excessive focus on membership capital is risky because it generally puts the corporate in a position where it is expected to pay an attractive yield on such capital shares. Many corporates that have attracted large amounts of membership capital now face a dilemma, as they are expected to pay a high rate of return on membership capital shares in the midst of dealing with struggling investments.

[12] 12 C.F.R. §704.2 (2009).

[13] GAO at 17.

Increasing Reliance on Membership Capital

Over the last decade, corporates have been increasingly reliant upon less permanent forms of capital in lieu of retained earnings.

According to a 2004 GAO report on the overall corporate industry, from 1998 to 2003, retained earnings diminished while PIC and membership capital shares grew steadily.[14] The GAO report predicted:

> "While this is a method corporates can use to increase capital during periods of rapid growth in assets, it does lead to concerns about the ability of the network to withstand financial shocks, especially in light of the increasingly challenging business environment they face."[15]

By focusing our main efforts on increasing retained earnings, EasCorp has largely avoided the harmful consequences of overextended commitments to membership capital and the responsibilities associated with a large subscriber base.

Disclosure Requirements For Secondary Capital Transactions

While PIC and membership capital requirements are gaining popularity, EasCorp believes that disclosure for secondary capital transactions is not extensive enough under the current regulatory scheme. Many members purchasing 3-year notice accounts are familiar with the terms and conditions of their shares, but we believe they are not always adequately informed of the riskiness of those investments. Similarly, risk disclosures are also insufficient in many situations where members convert their membership shares into PIC accounts. Therefore, the regulations should be updated to require substantially increased risk disclosures in these types of secondary capital transactions.

EasCorp has executed transactions that incorporated increased risk disclosures. In 1999, we sold PIC notes with a 20-year maturity, and in 2006, we converted those notes into perpetual PIC. In both of these transactions, we provided extensive disclosure surpassing regulatory requirements. Although these offerings were exempt from registration under the Securities Act of 1933, we believed they were subject to the anti-fraud and reasonable accuracy provisions in Section 10(b)-5 of the Securities and Exchange Act of 1934. Therefore, we provided a full written disclosure to our participating members describing the risks inherent in these offerings and emphasizing that PIC notes were not deposits and were not guaranteed.

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[14] GAO at 17.

[15] GAO at 17.

Adequate risk disclosures have not always been provided throughout the industry in connection with efforts to raise PIC and perpetual PIC offerings. Instead, conversions of membership capital to a PIC account have taken place without (1) notifying them of the risks inherent in this transaction, or (2) recording these representations in writing. Disclosure requirements should be addressed by revising the regulations.

Risk Based Capital

Required Capital Contributions

Perpetual paid-in capital (PPIC), or Tier 1 capital, is recognized for GAAP purposes and by capital markets as permanent capital. We believe that corporates should be permitted to make a PPIC contribution a condition of membership. However, the regulations should not require that NPCUs make a PPIC contribution to become a member of a corporate. This is a decision that should be left to each corporate, not the regulations.

Liquidity and Payment System Proposals

Definition

The NCUA has not defined the term "payment systems" in the ANPR. Here, we assume that a payment system consists of the settlement and transfer activities that are associated with share drafts, cash orders, credit card transactions, etc. Although payment and data processing are often associated with payment systems, we assume that the NCUA is referring to the settlement of funds.

Separation of Functions

To the extent that definition is accurate, EasCorp believes that corporates do not need to be separated into two companies (one for settlements and overnight money, and another for investing), so long as proper investing procedures are maintained and sufficient cash flows are earmarked such that a corporate will not run out of necessary cash. Similarly, to divide the functions by two charters would present administrative burdens that are likely unnecessary given that both settlements and payment processing can be effectively managed within one company under appropriate oversight. We have put numerous protections in place to ensure that sufficient funds are available for both overnight purposes and for investment purposes.

Historically, corporate credit unions were designed to provide liquidity to their member NPCUs. Corporates plan for member withdrawals and cash advances by managing balance sheets in a way to ensure a sufficient amount of cash on hand every night. Throughout the years, we have adhered to our mission statement and have not taken excessive investment risks that threaten our settlement activities.

Structure: Two-Tiered System

Current Structure

The credit union system is two-tiered: corporate credit unions service NPCUs, and U.S. Central exclusively services corporates. EasCorp recognizes that U.S. Central has a vital role within the corporate system that must be preserved. However, like all other credit unions, we believe U.S. Central exists to serve its members' best interests. Therefore, U.S. Central should operate with a very limited mission and a very limited investment authority.

Recent Developments at U.S. Central

In the past few years, U.S. Central has leveraged its balance sheet to excess, and as a result, has been significantly impacted by the recent downturn in the economy. As previously mentioned, excessive risk taking with asset- and mortgage-backed securities led NCUA to seize U.S. Central and place it into conservatorship.[16] In order to prevent a similar situation from repeating in the future, we believe U.S. Central should face strict limits on leveraged borrowing.

Importance of U.S. Central

Modifying the two-tier structure and eliminating U.S. Central would significantly weaken the group of corporates nationwide. Corporate members would have to find alternate providers for many services already provided by U.S. Central, eliminating the economies of scale and synergies that have contributed to the success of the industry. U.S. Central has a critical role for corporates, but we believe this role should be decreased, and U.S. Central should operate with very limited authority in the future.

Independent Businesses

Additionally, U.S. Central and the NCUA must reconsider the individual situations of all credit unions nationwide. Every NPCU, corporate and warehouse credit union is an independent company that has to accumulate core capital and meet certain regulatory requirements. As such, they are individual businesses in the same industry, not interdependent entities as is often implied through the use of terms such as "system" or "network." We believe that it would be wrong for NCUA to mutualize a problem at one or more corporates and force other corporates to transfer their capital when the only interdependencies between them are participation in the NCUSIF.

[16] Media Release – NCUA Board Meeting Agenda Modified, available at http://www.ncua.gov/news/press_releases/2009/MR09-0320.htm.

Asset Liability Management

Income Simulation

Generally, EasCorp uses NEV modeling to evaluate the financial condition of a financial instrument in light of interest rate risk. We favor NEV modeling because it is timeless and allows us to do a present value evaluation of any financial instrument. We do not rely upon net interest income modeling to the same degree, because it projects revenues and expenses, based upon select interest rate environments, through a very limited time horizon of reliable forecasting. Although net interest income modeling should not be used on its own to evaluate financial instruments, we believe it provides an effective way to complement other asset liability management tools.

Corporate Governance

U.S. Central Governance Reform

Conflicts of Interest

U.S. Central is governed by representatives elected from its membership. We believe there is significant potential for conflicts of interest at U.S. Central given the individuals who serve on the board and their vested interest in their own corporate credit unions and who may be in direct competition with U.S. Central. Accordingly, we believe that its board members, at least in part, should be chosen from outside of member corporates to ensure that decision-making is unbiased and in the best interests of U.S. Central's members. In the alternative, conflicts of interest may also be avoided by limiting U.S. Central board membership exclusively to individuals affiliated with active service users.

Lack of Transparency

Recently, as U.S. Central became more illiquid and further leveraged its balance sheet, it was granted several waivers by the NCUA that provided an exemption from certain regulations and the flexibility to operate without the customary level of oversight. However, its members were not provided full disclosure of the extent of these waivers. As a result, we were unable to include these effects of these regulatory devices in our investment decisions, as it was difficult to discern the types of requirements U.S. Central was being held to. In many ways, U.S. Central was able to mask its true health from its members through these exemptions.

We suggest that, in the event that NCUA provides waivers to regulations in order to stave off financial hardship, full disclosure be made available to the member credit unions in order to avoid the effects of incomplete information.

Additionally, earlier this year, U.S. Central secretly changed its membership capital rules regarding flexible capital accounts in a manner we believe was invalid. We believe the regulations should be revised to clarify that such a retroactive rule change is prohibited without a member's consent.

EasCorp's Approach to Governance

EasCorp requires that our board members be representatives of NPCUs that have made a capital investment in EasCorp, in order to better align interests. However, we believe that the choice to require a capital contribution should be made by the individual corporates, not by the regulations. Additionally, we do not require that members contribute capital in order to vote for board members. This decision should also be left up to the corporates, not the regulations.

In closing, we thank you for this opportunity to comment on the ANPR.

Sincerely,

Jane C. Melchionda

Jane C. Melchionda
President/CEO

JM/md