Financial Partners
CREDIT UNION
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February 3, 2010

Ms. Mary Rupp
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314-3428
Re: Comments of Part 704 Corporate Credit Unions

Dear Ms. Rupp:

Financial Partners Credit Union appreciates the opportunity to comment on NCUA's proposed amendments to Part 704, which would make major revisions regarding corporate credit union capital, investments, asset-liability management, governance, and credit union service organization (CUSO) activities. We recognize that the NCUA Board and staff have spent an enormous amount of time, effort, and consideration in researching, discussing, soliciting and evaluating input, and creating the Advanced Notice of Proposed Rulemaking and this proposed rule. NCUA's desire to improve and strengthen the corporate system is evident in the scope and breadth of this proposal. However, we regret to state that in our view the proposal raises more substantial concerns than it provides realistic solutions. There are several provisions that, if enacted as proposed, will make it essentially impossible for corporate credit unions to operate in a viable fashion. Further, many of these provisions will have harmful effects on natural person credit unions and, ultimately, their members.

Our comments are organized as follows:

Critical Issues of Concern

- Legacy Assets
- Time Period for Capital Ratio Attainment
- Retained Earnings Growth Model
- Average-Life NEV Testing
- Weighted Average Asset Life
- Penalty for Early Withdrawals on Corporate Certificates

Other Areas of Concern

- Perpetual Contributed Capital
- Overall Limit on Business Generated from Individual Credit Unions

We welcome dialogue with NCUA on these issues. Given what is at stake—the possible viability or non-viability of a credit union owned corporate system—we ask that NCUA consider another round of proposed rule making for Part 704 before issuing final rules to govern corporate credit unions.

Critical Issues of Concern

Financial Partners is concerned that if the following issues are left unchanged, there will be severe, and possibly unrecoverable, repercussions to corporate credit unions, which in turn would have harmful effects on credit unions that rely upon them.

- **Legacy Assets in Corporate Credit Unions**

Although the subject is not discussed in the proposal, addressing the issue of legacy assets is vital to realizing any lasting, consequential changes to the corporate system. Investment securities remaining on corporates' books continue to create instability in the network, and serve as a major disincentive to credit unions providing any future capital contributions. Financial Partners urges NCUA to cooperatively and transparently address the business and regulatory issues associated with these assets. We believe that failure to do so invites the weakening of even currently stable corporates, and would serve to negate the positive changes that NCUA and credit unions would like to see in the corporate system.

- **Time Period for Capital Ratio Attainment**

The one year window required by the proposal to attain the risk-based capital ratios (i.e., the 4% Leverage Ratio) will require corporates to bring in new capital or, at a minimum, convert existing MCA to the new PCC during a time when significant issues remain unresolved regarding legacy assets. Due to a lack of sufficient retained earnings at most corporates, and an inability to grow retained earnings at a rate required by the proposed rule, (see our discussion below), member credit unions will likely be asked to contribute approximately 4% of the corporate credit union deposits as perpetual capital within 12 months of the publication date of the final rule.

Financial Partners would be extremely hesitant to contribute additional capital in such an uncertain environment. We may decide to pull our deposits from the corporate system as the result of such a precipitous move to achieving a 4% Leverage Ratio via PCC. This, in turn, would lead to liquidity concerns for corporates. Given the unavoidable reality that credit unions will need longer than one year before they will feel comfortable recapitalizing, the NCUA should consider: (a) some kind of financing or capital note (equivalent to 4% of a corporate's balance sheet) will be required to meet corporates' operational needs; and (b) the proposal's time period for attaining the risk-based capital ratios must be extended to at least three years.

- **Retained Earnings Growth Model**

We take issue with NCUA's assumptions regarding a corporate's ability to grow retained earnings under the proposed investment and ALM limitations (pages 99-101 in the proposed rule), and are of the opinion that it does not represent a reasonable or attainable mix. For example, NCUA's model appears to work because it allocates 10% of the investment portfolio to a fairly high risk, extremely illiquid sector – private label student loans. This is on top of a 20% allocation in government guaranteed student loans. We believe it is unrealistic and unsound to allocate 30% of a portfolio to the student loan sector. (In fact, it is doubtful that a corporate could even find enough of these risk assets to make such a model work.) This single sector of NCUA's model accounts for an astonishing 75% of the interest income. We believe this violates principles of concentration risk, represents too much exposure, and is not indicative of attainable real-world results.

The investment mix that includes loans, ABS-Autos, ABS-Credit Cards, FFELP Student Loans, Structured Agency, Bank Floaters, Other Short-term, MBS-CMBS, and Overnight, it is projected that net income of 14 bps can be realized. However, we must point out that even this would be insufficient to meet the proposed capital targets. Even at 14 bps, a corporate would be short 7 bps of NCUA's model scenario in which projected net income of 21 bps would hypothetically allow for adequate building of retained earnings.

- **Average-Life NEV Testing**

The proposal requires average-life mismatch net economic value (NEV) modeling/stress testing, in addition to existing interest rate risk (IRR) NEV modeling, to include:

• A 300 basis point credit spread widening, coupled with a NEV ratio decline limited to 15 percent;
• A 50 percent slowdown in prepayment speeds to determine if the corporate has excessive extension risk; combined with
• A portfolio/asset limit of two years in average weighted life.

Financial Partners does not believe that there is a combination of assets—with a two-year average life and limited extension risk—that could generate sufficient margin to attract funding and pass a 300 basis point credit shock test. Further, the proposed limitations placed upon a corporate by these tests would not allow corporates to generate sufficient interest margin to build retained earnings to meet the new capital requirements contained in the proposal. (The 2 year average weighted life limitation will make holding Agency and Private Label Mortgage Backed Securities—the largest sector of potential investments—virtually impossible for corporates.) Any ability to generate a reasonable interest margin in order to build retained earnings will become very dependent upon a lower cost of funds for corporates, which means a lower yield paid to members.

In our view, the proposed spread widening of 300 bps appears to be an over-reaction by NCUA to a once-in-a-lifetime, completely unique event. Historical analysis indicates that, over the past 15 years, excluding recent events, credit card and auto ABS credit spreads to LIBOR widened to a maximum of approximately 50 bps, and generated a standard deviation of spread volatility of approximately 10 bps.

- **Weighted Average Asset Life**

This provision limits the weighted average life (WAL) of a corporate credit union's aggregate assets to two years, and includes loans to members. Such a requirement will have adverse implications for natural person credit unions seeking to fill liquidity needs with term loans from corporates. In order to keep the overall WAL of its portfolio within the two year limit, most of the loans made by a corporate will be limited to shorter-term maturities. For longer-term loans, a corporate will have to substantially increase the rate offered in order to compensate for the impact the longer term will have on its two year WAL test.

As a result, long-term financing to natural person credit unions will be drastically reduced, and will come with a much higher borrowing cost. The two year proposed limitation will limit our borrowing option to the Federal Home Loan Bank which though comparable in price requires more assets to be pledged than our Corporate. Therefore, we request the Board to exclude loans from the calculation of weighted average life of the investment portfolio. After all, the original purpose of corporate credit unions was to enable financial intermediation between credit unions—not only their short term needs but also medium and long term needs.

- **Penalty for Early Withdrawals on Corporate Certificates**

This proposed provision limits a corporate credit union's ability to pay a market-based redemption price to no more than par, thus eliminating the ability to pay a premium on early withdrawals. Such a change will pose a significant disincentive for member credit unions seeking liquidity, and will likely lead them to seek more competitive investing options than corporates. As a result, corporates' institutional funding market for term certificates will be severely impaired—or even wiped out—which will lead to a significant reduction in overall liquidity in the corporate credit union system. We urge the Board to strike this proposed requirement from the final rule, as it is not only counterproductive to maintaining corporate liquidity and natural credit union investment options, but would likely have long-lasting and harmful effects to the system.

Financial Partners firmly believes that the Board should forego finalizing the above critical issues in their current proposed form, and should carefully assess all comments and analysis NCUA receives regarding the viability and reasonableness of the tests and the two year average weighted life limitation, as well as the capital ratio attainment and the retained earning growth assumptions. NCUA should also review whether historical trends justify the proposed tests and thresholds. The NCUA should publicly provide its modeling tool and/or assumptions. Our doubts and concerns regarding these proposed provisions are further amplified when we consider that NCUA may choose to incorporate them into planned revisions to Part 703, which will have similar, debilitating effects on natural person credit unions.

Other Concerns

- **Perpetual Contributed Capital**

At this time Financial Partners is unwilling to re-capitalize WesCorp, especially under the proposed rule and potentially taking another loss on our investment in WesCorp. If forced to choose, Financial Partners will move its business to other competitors in the market place that provide services similar to what we receive at WesCorp.

- **Overall Limit on Business Generated from Individual Credit Unions**

This provision prohibits a corporate from accepting from a member credit union or other entity any investment in excess of 10 percent of the corporate's daily average net assets, with the objective of reducing risks that could arise from placing undue reliance on a single entity. Many corporates avail themselves of inter-month funding when needed to address short-term liquidity volatility. Typical sources of these funds include the Federal Reserve Bank and the Federal Home Loan Bank. Therefore, including "or other entities" in the 10 percent limit may force corporates into short-term borrowing with less favorable terms. It would force corporates to maintain larger cash balances, which would likely be detrimental to earnings. This provision, as written, may limit corporates' ability to provide their credit unions with reasonably priced short-term liquidity.

We suggest that NCUA consider allowing borrowings with a maturity of 30 days or less from either the Federal Reserve Bank, a Federal Home Loan Bank, a Repurchase
10 Agreement counterpart or a Federal Funds counterpart, in excess of 10% of the corporate credit union's moving daily average net assets. Alternatively, this issue could be addressed by eliminating the "or other entity" language of the proposed limitation.

Sincerely,

Mary K. Torsney
Vice President, Finance
Financial Partners Credit Union

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