SAFE CREDIT UNION

February 11, 2010

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

Re: Proposed Regulation 12 CFR Part 704

Dear Ms. Rupp:

The NCUA Board has drafted Proposed Regulation 12 CFR Part 704 directed at the nation's corporate credit unions (CCUs). We thank NCUA for allowing comments on the proposed rule changes. Ultimately, this proposed regulation will affect a large number of natural person credit unions (NPCUs). Many of these NPCUs have lost millions of dollars through the extinguishment of member capital at the nation's CCUs.

We feel that the NCUA Board has omitted an important step in the process of regulating CCUs. The first step in the process should be a post mortem to determine what caused the failure of the CCUs. NCUA's mission is to assure safety and sound operation of credit unions to protect member's deposits and information and to protect the share insurance fund. NCUA has been directed by Congress to use prompt and corrective action to protect both member deposits and the share insurance fund. The losses in CCUs have eclipsed any other loss in the history of credit unions. The current unrealized losses in the CCU system exceed $30 billion dollars. If these losses were absorbed by CCUs they would represent nearly 500 basis points of assets. The magnitude of the losses points to a failure of prompt corrective action. The failure of CCU management and NCUA to prevent losses to members of CCUs and the share insurance fund and perhaps ultimately to members makes it apparent that there should be a thorough and complete public examination of the causes leading to the failure of the CCU system. We recommend that NCUA consider the Truth Commission in South Africa as a model. The object of the examination is not to place blame but rather to bring transparency to the causes so that before we make new rules we determine what went wrong.

The last major CCU failure resulted in NCUA rule 704 and other changes to how these institutions were regulated and supervised. Those rules did not prevent the current losses and it is likely that unless there is full transparency and a through examination of the causes of this failure that there will be another failure in the future. Rule making by itself will not prevent future losses. Rule making without a public examination of the causes of the failure is a failure

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of process. It may be that the current rules are adequate to assure safety and soundness. It may be that the causes of the failure lie outside the credit union system. It may be that changes need to be made in how other regulators regulate rating agencies and investment banks that packaged and sold the investments to the CCUs. The current proposed rules do not address the possibility that faulty examination processes prevented or avoided prompt corrective action that could have limited or even prevented the current losses.

The "unintended consequences" of requiring CCUs to have AAA-rated securities actually helped intensify the losses. The real problem was not that corporate credit unions took excessive risk but rather that the regulations restricted the diversity of investment options and focused them on those investments that were the epicenter of the credit disaster. Had CCUs invested in high yield junk bonds, they would have done better. The failure to look at causes dooms the proposed rule making from helping to prevent the next crisis. Why isn't NCUA looking at the rating agencies that rated securities AAA only to see them drop to junk status within months?

We therefore recommend that NCUA hold public hearings with testimony from CCU Board members, management, CPAs, NCUA CCU management, and CCU third-party advisors and that NCUA make public all relevant documents including internal audit reports, NCUA examination reports, ALCO minutes and Board minutes. The $6 billion dollar price tag for this failure will be absorbed by NPCUs and their members. They have a right to know what happened. The credit union system cannot assess the merit of any proposed rules without a transparent review of the causes of the failures.

Even without knowing what caused the CCU failures, it is very apparent that the proposed rules would limit the ability of CCUs to be a liquidity source for credit unions and to have a viable business that earns sufficient net income in order to reach the required capital levels. The net effect of the business constraining effects of this proposed regulation could now effectively eliminate the CCUs entirely.

The major limitations in the proposed rule concern liquidity and investment returns. If not amended, these parts of the proposed rule will force NPCUs into the undesirable position of seeking alternative, possibly far more costly, and certainly more unreliable providers instead of managing liquidity through CCUs owned by NPCUs.

Of primary concern:

<u>704.8 (c) Penalty for early withdrawals on corporate certificates</u>
NPCUs have a choice when investing surplus funds. They can either invest in corporate certificates of deposit or buy (for example) agency securities. An agency security can be sold before maturity and under certain circumstances, earn a premium. CCUs must be able to compete with agency securities. NPCUs have benefited from enhanced yields on excess funds placed with CCUs, but it is not clear why NPCUs would not able to obtain a premium on certificate redemptions if it needed liquidity. If this proposed change remains, NPCUs will be forced to put longer-term, investable funds elsewhere in liquid instruments that do not penalize early redemptions. The net result will be the effective end of corporate certificates as a competitive investing option. This proposal should be removed.

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704.8 (d), (e) & (f) NEV sensitivity analyses

Analyses have been done by the California Credit Union League that show the requirements of the proposed regulation places stringent limitations on CCUs through various NEV tests. It appears the proposed NEV tests will not allow the CCUs to generate sufficient interest margin to build retained earnings to meet the proposed capital requirements. If enacted as drafted, this proposal will inevitably lead to increased fees and force CCUs to seek expense reductions that will adversely impact the level of service and support for NPCUs. The rule should be revised to allow for CCUs to make sufficient income from the balance sheet to grow and invest in innovation for the benefit of all their member credit unions, while exercising an acceptable level of credit and interest rate risk.

704.8 (h) Weighted average asset life

CCUs act as liquidity providers for both short- and long-term needs. SAFE Credit Union has historically used the investment portfolio as a way to manage overall interest rate risk. Our investment portfolio has in low rate environments been kept very short and in stable interest rate environments has been invested in a two to five year laddered portfolio. The proposed regulation places severe limitations on asset maturities and asset average lives which may impact NPCUs ability to manage interest rate risk and use CCUs as our primary supplier of term liquidity. This means NPCUs will have to look outside the CCU system for likely more costly and unreliable funding alternatives.

704.14 (a)(2) Representation Qualifications of Directors

The proposed rule requires the majority of CCU directors to be representatives of NPCUs. While this is appropriate the proposed rule should also require the CCU board to be comprised of at least one member (and preferably more) who is a "financial expert". SAFE Credit Union has had our CEO, a former CCU Chairman and our CFO serve as CCU volunteers. It is our belief that most NPCU officials do not have the training or experience necessary to understand the complexities of CCU investment portfolios. We realize that over time the CCU will train its volunteers. However there is no substitute for training and experience. The Sarbanes Oxley regulation recognizes that need and defines the term "financial expert." We recommend that definition be expanded for use in the proposed rules. A "financial expert" would be required to have experience in analyzing or evaluating financial statements, corporate investments, and operations strategies of a breadth and complexity comparable to that included in the CCU's financial statements, or has experience actively supervising persons engaged in such activities. The proposed rule should also require, in conjunction with the above requirements, at least one independent, non-NPCU director. This independent director must be required to have experience consistent with the "financial expert" noted above.

704.19 Disclosure of executive and director compensation

Given the size and complexity of CCUs it is understandable why there should be greater transparency of executive and director compensation programs. The proposed rule should mirror the IRS Form 990 guidelines for officers, directors, key employees and highly compensated employees similar to the rules now applied to NPCUs. CCUs should report compensation for both current and former officers, directors, key employees and highly compensated employees. CCUs should also report compensation received from related organizations including credit union service organizations (CUSOs). Like the IRS Form 990, the information should be publically available at little or no cost either by mail or in person.

704.8 (k) Overall limit on business generated from individual credit unions
Placing a limit on the aggregate investment in a CCU that comes from any individual credit union makes sense. However, the current limit of 10% may force a CCU into short-term borrowings with less favorable terms regarding price, maturity and collateral. It may also be damaging to the corporate's earnings: It would force corporates to maintain larger cash balances, which would likely be detrimental to earnings. This proposal may limit CCU's ability to provide NPCUs with reasonably priced short-term liquidity.

The proposed rule should also allow borrowings with a maturity of 30 days or less, from either the Federal Reserve Bank, a Federal Home Loan Bank, a Repurchase Agreement counterpart or a Federal Funds counterpart, in excess of 10% of the CCU's moving daily average net assets, by eliminating the "or other entity" part of the proposed regulation. Alternatively, consider allowing a higher borrowing limit of as much as 20% of the corporate's moving daily average net assets from these entities.

We believe the concern about concentration limits is valid. It forms the basis for our concern that NCUA needs to more formally address the consolidation of CCUs and the structure of the CCU system. Today there are CCUs that are smaller that many of our larger credit unions. These smaller corporates are an artifact of the old three tier CCU system in which many corporates were essentially pass through entities that took deposits and invested them with US Central. The proposed rules cannot fully address concentration issues without addressed the future structure of the CCU system. After CapCorp, the NCUA missed an opportunity to direct the structure of the CCU system. The national fields of membership granted by NCUA created a "survival of the fittest" rate competition between corporates that may have increased the risks to the credit union system. NCUA should take an active role in discussing with NPCUs the type of structure, services and business model for a new CCU system. We suggest that the FHLB model be considered. We suggest that corporates have the ability, like the FHLB, to raise funds with the full faith and credit of the US Treasury, to provide liquidity in the form of loans to credit unions to support consumer lending and small business lending.

704.11 Corporate Credit Union Service Organizations
The proposed rule should provide a clearer definition as to what will be permissible in the final rule regarding CUSOs. In its current form the proposed rule will make it extremely difficult for CCU's to find qualified CUSO partners with whom to offer NPCUs the competitive products and services they need. Third-party product providers to NPCUs will not want to give NCUA free access to books, records, software and operations solely because a CCU may be a minority partner in their business. Ultimately, this may force CCUs to eliminate these partnership opportunities that bring efficiency to all NPCUs.

Furthermore, as the NPCU product demand continues to evolve, the expense of producing those products may become prohibitive. Many NPCUs are creating CUSOs to help produce innovative products at a minimum cost. NPCUs rely on CCUs to join the CUSO because they bring considerable expertise that is not readily available to most credit unions. Proposed rule changes in this area should be limited to only those joint ownership situations where the CCU has a controlling interest in the CUSO.

Prompt Corrective Action

Congress has mandated that NCUA take prompt and corrective action to protect the credit union system, the insurance fund and credit union members. NCUA had an examiner in charge on site in both Wescorp and US Central. NCUA had complete access to all internal documents on a real time basis. NCUA devoted substantial examination resources for on-site annual examinations. NCUA Chairman Fryzel told credit unions when Wescorp and US Central were conserved that "now we will get honest answers." An independent review should be conducted of NCUA's examination process. How could NCUA with full time, onsite examiners and with a dedicated CCU examination division fail to have "honest answers?" We should accept Chairman Fryzel's frustration as prima facie evidence that the examination process did not work and that whatever flaws exist must be remedied.

Risk Based Net Worth

Most of the world's financial institutions use risk based net worth standards to assure that there is adequate net worth to offset the risks in the balance sheet. Corporate (and NPCUs) should adopt risk based net worth as the basis for net worth standards.

Recapitalization of Corporate Credit Unions

It is clear that throughout the history of the CCU system that the ultimate exposure for losses was at the NPCU level. The three tier system was capitalized at each level. Capital levels at the US Central and at the middle CCU level were never adequate. As we have seen in this crisis the ultimate liability for losses has fallen on NPCUs. If a new CCU system is developed, net worth standards must be adequate to cover the risks in the balance sheet. Any capital standards should be risk-based.

It is almost certain that member capital will have to be used to capitalize the CCUs. We recommend that NCUA set risk-based capital standards and allow members and their corporate decide whether to make member capital a requirement for services.

We recommend that the proposed rules clearly set out the rights of member capital in the event of unrealized losses. NCUA prejudiced the rights of member capital owners by arbitrarily writing off member capital. Granted it does not appear there will be any recovery. But regardless, member capital owners deserve the chance to recover a pro rata share of their capital if unrealized losses do not exhaust member capital.

The $30 billion of unrealized losses in the CCU system must be addressed. No one will invest in member capital if the toxic assets remain on the CCU balance sheet or in the alternative if the liability for future losses is not addressed.

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The above areas comprise my major concerns with the proposed rule change and I hope that my comments are sufficient to prompt reconsideration of the rules as I have described them. If left intact, the proposed rule changes will expose my credit union to increased costs, fewer competitive investment options, lower rates on deposits and fewer credit union-owned services.

I urge you to seriously consider the above suggested revisions to the proposed rule as well as offer another 90-day comment period for the public to evaluate and submit feedback to such revisions.

Sincerely,

Henry Wirz
President/CEO
SAFE Credit Union