February 15, 2010

To: Mary Rupp
Secretary of the Board
National Credit Union Administration
regcomments@ncua.gov

From: Mike Valentine, President/CEO
Baxter Credit Union
340 North Milwaukee Avenue
Vernon Hills, IL 60061

Re: Comments on proposed Corporate Credit Union regulatory changes

---

General Comments:

Goals and Objectives

- The goals of the proposed regulatory changes are admirable. We agree with the need to prevent further systemic failures by bolstering Corporate Credit Union (CCU) capital levels, limiting risk, and focusing on core credit union services.
- BCU actively uses both Members United CCU and Wescorp. We use the CCUs because of favorable pricing on settlement services, low cost lines of credit, service quality, and attractive overnight rates. Our decision to recapitalize will hinge on whether we feel the CCUs can continue to provide value and concurrently have an appropriate business model that will ensure long term viability and protection of the capital deposit. We would expect our partner CCUs to provide sound business plans to help us make this recapitalization decision.
- There has been a good deal of discussion on the issue of whether CCUs are necessary for the Credit Union System. We feel that elements of the CCU system are very important to the health of the CU movement and would agree that having to rely on bank support could be detrimental. To augment the idea of shared resources within the Credit Union Movement, NCUA should consider granting corporate credit union authorities to NPCUs. These privileges should be limited to NPCUs with sufficient expertise, scale, and capital.
- NCUA should consider hiring an independent firm to analyze the long term financial viability of the CCU model. The firm should analyze and report on the benefit achieved from CCU consolidation. We feel that consolidation of CCUs is critical to their future success. We agree with the NCUA stance on letting the market drive the consolidation of the CCUs, however we would recommend that NCUA consider some kind of facilitation to achieve this goal.

Legacy Assets

- Although recently discussed in public, the issue of legacy assets is not addressed in this proposal. We would be reluctant to recapitalize if there exists the potential of further OTTI related to legacy assets that will quickly impair the freshly deposited capital.
- Without resolution of this issue, we feel that there would be little to no voluntary consolidation or recapitalization of CCUs. The necessity of Purchase Accounting treatment would dissuade CCUs

from wanting to accept the current market value of distressed assets and undercapitalized merger partners.

- Ideas: We prefer the concept of NCUA/NCUSIF/Treasury purchasing the legacy assets at the current market value (recorded on CCU books). NCUSIF is ultimately on the hook for these assets, so we feel that it will facilitate growth and confidence if these assets are isolated and removed from the CCUs. We are undecided as to whether these assets should be kept on NCUA's books or in a separate organization. We are not as comfortable with the alternative idea of leaving the legacy assets in zombie CCUs while opening new CCUs to serve NPCU needs. It would be administratively burdensome. It would also have the potential of becoming very prescriptive in terms of NCUA dictating which new CCUs are allowed to reopen.
- We recommend that if the recognized credit losses on the legacy assets are less than the OTTI, then the gains should be allocated pro-rata back to the NPCUs that had membership capital in the respective CCUs. We feel that booking the gains to the NCUSIF and indirectly allocating back to all NPCUs would be unfair.

Government Guarantee

- There are elements of the FHLB, FAMCA, and FFCB systems that could serve credit unions well, most notably the ability to raise low cost funding through implicit government guaranteed debt. By consolidating and pooling CCU funding through government backed bond offerings, the CCUs would have access to both low cost funding and Tier 2 capital.
    - We believe the bonds would be well received given the solid reputation of credit unions in the marketplace
    - This would allow CCUs to no longer rely so heavily on funding through NPCU overnight deposits. Bond funding would be beneficial because it could be counter-seasonal and would have a longer duration, thus offsetting some longer term asset duration.
    - With the Federal Reserve Bank now offering competitive rates on excess reserves, CCUs will have more competition for overnight funds. This could add more liquidity risk to the CCUs.
- We recommend that NCUA commence a study on how such a government backed funding consolidation could work in the credit union environment.

<u>Specific Comments:</u>

Capital Requirements:

- There is some concern about the change to 704.3(d) in that it may prompt the CCU to then increase capital requirements for its members. We would like to see the language changed to require the CCU capital position improvement to come from Retained Earnings or PCC.
- We are uncomfortable with the idea of increasing the minimum capital requirements for larger NPCUs. The immediate concern would be the risk of again having to impair the capital deposit. In a more macro sense, larger NPCUs have more alternatives to using CCUs, so we would be concerned that higher capital requirements could further dissuade them from rejoining and recapitalizing.

NEV Testing:

- Paragraph 704.8(f): This new paragraph introduces a separate spread widening test assuming a 50% slowdown in prepayment speeds. It is unclear whether this test is to be performed on top of the 300bps IRR NEV and AL NEV tests. Even as a standalone test, presumably meant to account for prepayment modeling error, the 50% slowdown in prepayment speeds is excessive. We feel that a 20% slowdown assumption is more realistic and would capture much of the modeling variability intended by this proposal.

Investment Limitations:

- Paragraph 704.6: We recommend adding more focus on credit risk. Multiple NRSRO ratings may be insufficient in identifying systemic credit risks. We feel the following requirements should be added:
  - Geographic concentration limits for asset backed securities
  - Regular analysis and public reporting on the performance of the underlying collateral.
  - CCUs must develop sufficient talent to monitor and act on changes in the credit quality of investments
- Paragraph 704.8(h): The two year weighted average life requirement is too restrictive. We feel it should be three to five years for the following reasons:
  - CCUs currently have strong talent and systems in place to manage interest rate risk. In addition, much of the current problem stems more from credit risk
  - Given the steepness of the yield curve, CCUs should be allowed to go out longer on the curve to achieve the higher required earnings that are modeled in this proposal. Without the ability to improve the margin by taking advantage of the yield curve, the business model appears to be unsustainable in building adequate capital levels.
- We feel that there has been too much reliance on monoline insurers for previous asset purchases. We propose the following:
  - If not required already, stipulate the same underwriting and credit risk requirements for assets purchased with insurance wraps
  - If not required already, stipulate the same underwriting and credit risk requirements for the monoline insurers themselves
  - Create a system with which the credit risk impact from the insurance wraps can be shocked given various economic assumptions. The resulting benefit from the wraps should then be discounted based on the volatility of their coverage

Governance:

- In addition to the changes proposed, we recommend the CCUs' Board of Directors have at least one capital markets expert from outside the credit union industry. This would provide the boards with an objective third party viewpoint on the CCU's balance sheet management.
- Likewise, we recommend that NCUA insure a high level of examiner and staff expertise with regards to capital markets and risk management. This could include retaining external expertise to assist in oversight as well as periodic NCUA attendance at CCU ALCO and Board of Directors meetings.
- We recommend that NCUA allow CCUs to compensate their directors. Although this will be an added expense, we feel that this will increase the likelihood of attracting quality talent to these boards during the difficult rebuilding years. It will also aid in the recruitment of outside talent as mentioned in the previous bullet.

Miscellaneous Provisions:

- Paragraph 704.8(c): We are unsure why this rule change is necessary and why CCUs have such an issue with it.

    - We feel that this rule change is unnecessary because the current practice is simply a pricing exercise. The CCUs have determined the price sensitivity and liquidity sensitivity of the depositors, and have priced the certificates accordingly.
    - We have not seen this value proposition offered by banks. Our experience has been when the market is in our favor, the certificates can be redeemed at par. Otherwise if the market has moved against us, the certificates have penalties. We are not sure why the CCUs argue the proposed change would put them at a disadvantage with banks.
- Paragraph 704.14: We agree with the concept of term limits, but feel that a six year maximum is too restrictive. The lack of continuity may cause inconsistency especially in a time when the CCUs need to focus on strategic execution.
- Financial Modeling: We feel that NCUA should consider the following items in its scenarios for future CCU financial health:
    - The financial model uses 0% cost of capital. This seems unreasonably low.
    - The concentrations in private student loan portfolios seems both unrealistic (not enough supply) and risky.
    - The 20bps of earnings projections seems overly optimistic. In the best of times, the CCUs had earnings in this range, so it would be difficult to envision how they would achieve this level of profitability with the proposed investment restrictions and the threat of further OTTI.
    - The recapitalization estimates also seem optimistic.
- Paragraph 704.11: We agree with the limits on the types of CUSOs and the enhancement of the transparency of the CUSOs. However, our fear is that CCUs, with an increasing regulatory burden and difficult earnings targets, may come to rely too heavily on CUSO income. The risk lies in too much concentration in CUSO operations and not enough oversight. Increased transparency is important, but so is the regulatory talent necessary to vigilantly monitor diverse CUSO business lines. We recommend that NCUA and the CCUs conduct an analysis to determine the risk exposure from concentration of CUSO earnings and set limits accordingly.

Summary

The key to future CCU success will be in the rebuilding of NPCU trust. To do this, the CCUs must articulate a business model that delivers value and ensures long term sustainability. We feel that some of the provisions in this regulatory proposal would impair the CCUs ability to do either. While we generally agree with the new capital requirements, we disagree with some of the NEV and investment limitations; specifically the 50% prepayment slowdown modeling and 2 year weighted average life restriction. In addition, we feel that the proposal needs to more fully address key issues such as legacy assets, enhanced underwriting, enhanced monitoring of monoline insurer impact, and CUSO management.

Sincerely,

Mike Valentine
President/CEO
Baxter Credit Union