February 17, 2010

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

Subj: Response to Proposed Rule for Corporate Credit Unions (12 CFR Part 704)

Dear Ms. Rupp:

First Carolina Corporate Credit Union (FCCCU) appreciates the opportunity to comment on the proposed changes to NCUA Regulation 704. As background, FCCCU is a $1.7 billion corporate credit union owned by and serving the needs of our 175 member credit unions primarily located in North and South Carolina. We support a regulatory environment that does not allow excessive risk-taking, however, a viable corporate credit union system needs to allow for some managed risk-taking to be able to add any value to its member-owners. There are numerous changes within the proposed regulation that we believe will improve the safety of the system, however, there are several sections of the proposed regulation that without modification will remove any value a corporate can provide its members. We do not believe that the proposed regulation if passed as is will provide a framework for a viable corporate credit union. Our comments and, as appropriate our recommendations, on the proposed changes to Regulation 704 are provided below.

We agree that the current corporate financial crisis can never be repeated. NCUA has implied that excessive concentrations and lack of liquidity were the common themes of the current crisis. We agree that concentration levels were extreme at several corporates, however, we believe the core problem leading to the current corporate financial crisis is the direct result of credit issues. Without the credit losses associated with the underlying collateral of the private issue mortgage-backed securities, the credit union system would not have sustained all of these “other than temporary impairment” charges. Liquidity always becomes an issue as a by-product of other troubles and in particular credit problems. Corporates who experienced large outflows of funds did so due to credit concerns. With completely illiquid assets, a liquidity crisis ensued. Once again, liquidity could have been funded with appropriate collateral, however US Central lost the majority of its borrowing capacity due to deteriorating credit related to its non-agency mortgage portfolio. Therefore, we would like to see a final regulation that places a priority on credit quality of investment portfolios while allowing more room for managing non-credit related risks. Although the proposed regulation does address credit risk by eliminating Level 2 expanded authorities, restrictions in the ALM modeling section greatly reduce the type of high quality investments in which a corporate may invest due to maturity (WAL) limitations. In many ways, the only way to pick up additional yield in short-term investments is to buy as much as possible at the lower end of the acceptable credit curve (First Carolina operates with Base Plus authorities and can only invest in bonds rated AA- or higher). Coming out of the recent mortgage crisis, credit risk is not something we are interested in pursuing and given where current interest rates are we certainly do not want to take on much interest rate risk. That leaves the need for some flexibility in managing liquidity risks to provide a corporate the ability to buy floating rate investments to generate necessary earnings. We believe the proposed restrictions contained within the ALM section of the regulation will not allow a corporate to meet required earnings targets and will lessen the value a corporate can provide its members. Our specific section-by-section comments follow.

704.2 Definitions

Adjusted core capital:

After 120 months, it states that a corporate must "deduct any amount of PCC that causes PCC to exceed retained earnings." As a capital account that qualifies as tier 1 capital, it should not be discounted from core capital at any time as it will remain a senior priority risk asset unless called. At a minimum, excess PCC should be included in the total capital ratio. In reading the definition of "adjusted total capital" a corporate can use NCAs in the total capital calculation to the extent that it does not exceed the corporate's aggregate PCC and retained earnings. Since most corporates will need to initially raise more PCC to meet the required minimum leverage ratio after year 3 than they will be able to use after either year 6 or 10, the excess PCC that is discounted from core capital should still qualify in the total capital calculation similar to the treatment given NCAs. This should be clearly stated in the regulation. Member contributed capital accounts should not be excluded from capital ratios as they remain available to cover losses in excess of retained earnings.

Recommendation: ***Allow PCC to remain a part of core capital while simultaneously requiring certain levels of retained earnings. As a minimum, "excess PCC" should be capital under the total capital ratio calculations.***

Leverage ratio:

It appears that the intent is to allow corporates to meet the leverage ratio requirement prior to 36 months using NCAs + PCC + retained earnings. However, following the definition of how much NCA can be used in the total capital calculations, it is restricted to an equal amount of PCC and retained earnings. Realizing most corporates are starting with little to no retained earnings or PCC, it appears that corporates would not be able to use much NCA in this calculation.

Recommendation: ***Prior to 36 months, a corporate would be able to use 100% of its NCA towards the leverage ratio, not just an amount equal to tier 1 capital.***

704.3 Capital

Callability of PCC:
A corporate credit union that meets the required capital requirements within the regulation should be allowed to call PCC on a pro-rata basis without regulatory approval. The capital belongs to the membership. The minimum capital requirements and PCA provisions protect the NCUSIF. In addition, the percentage of PCC that can be used towards a corporate's tier 1 capital ratio goes down over time as the regulation requires it to be replaced by retained earnings.

Recommendation: ***The board of directors of a corporate that exceeds all minimum capital ratio requirements maintains the authority to redeem/call PCC at its discretion without pre-approval of its regulator(s).***

Treatment of Non-converted MCSD:
The proposed regulation states that membership capital shares that are not converted to either PCC or NCA will no longer qualify as capital after 12 months. Since these accounts will remain a risk-asset to the credit unions during the 3-year notice period, they should continue to count as capital with the same treatment that current MCSD accounts on notice are given.

Recommendation: ***Continue to allow Membership Capital Shares to be counted as capital since it remains at risk until the completion of its notice period – similar to how MCS on notice is treated under current regulation.***

Retained Earnings Ratio Requirements:
Retained earnings are very helpful to a corporate in that it provides protection to member contributed capital and provides a source of no cost funding. The 45 basis point retained earnings ratio requirement may be very difficult to achieve if the current extremely low interest rate environment were to continue for several more years. Whereas NCUA has adopted minimum capital ratio requirements following Basel 1 Capital Standards, it has added many more limitations to which other financial institutions are not subject, such as a minimum retained earnings requirements. We understand the intent to build retained earnings to protect NPCU capital accounts. However, to achieve this goal corporates will need the ability to manage some level of portfolio risk to generate sufficient earnings. We do not believe the sample balance sheet used in the preamble to illustrate how a corporate can achieve appropriate earnings accurately estimates ongoing spreads we are likely to be able to obtain in the market or availability of those assets in such short durations. We also take exception to a model balance sheet consisting of a higher percentage of term liabilities than overnight. With tighter capital ratios, we believe the majority of a corporate's liabilities going forward is likely to be short-term deposits (90 days & under).

Recommendation: ***Revise this section to require a corporate to generate positive net earnings without setting minimum retained earnings requirements so that a corporate is not put in a position of being forced to assume additional risks to achieve a specified return that may not be prudent under certain market conditions.***

Appropriate considerations for establishing individual minimum capital requirements (704.3)(d):
We are very concerned with the subjectivity proposed in the regulation regarding NCUA's ability to amend a corporate's required capital levels. The proposed regulation states that capital "cannot be determined solely through mathematical formula, but must be based in part on subjective judgment grounded in agency experience." Subjective minimum capital ratios make it near impossible to ensure members who re-capitalize their corporate that the levels achieved are adequate to safeguard their capital from being subjected to Prompt Corrective Action measures as described within the proposed regulation.

Recommendation: ***Capital calculations should not be subjective. NCUA needs to develop methods to ensure consistency when measuring capital standards.***

Reservation of Authority (704.3(e)(3):
We are unclear as to the applicability of this section. If a capital account (PCC or NCA) meets the definition and terms of these capital accounts as stated within this regulation, it should not be subject to discounting. The regulation provides NCUA the authority to require higher minimum capital ratios if they are concerned with risks within a corporate credit union's operation. There should not be the additional authority to disallow a capital account that meets the definition of capital within these regulations.

Recommendation: ***As long as a capital account meets the definition of the various capital accounts allowed in this regulation, it should not be discounted as capital per any subjective interpretation.***

704.4 Prompt Corrective Action (PCA)

Reclassification of Capital Ratings:
NCUA has included in the proposed regulation the ability to immediately downgrade the capital classification of a corporate if it receives a category or composite rating of 3-5. This appears to give the NCUA the ability to place a well capitalized corporate into a potential PCA situation at any time as most corporates have probably received an individual component rating of 3 sometime over the past 10 years. Again, NCUA needs to develop a consistent methodology in determining a component rating of 3 or worse besides relying on the subjective determination of an individual examiner of OCCU. If a corporate is downgraded to a component rating of 3 or lower, the NCUA needs to allow for an appropriate time frame for a corporate to resolve the deficiencies.

Recommendation: ***There needs to be sufficient corrective response time allowed for a corporate to resolve any less than satisfactory rating prior to being downgraded to PCA status.***

704.5 Investments

We have no suggested changes to this proposed section of the regulation. We support the elimination of Level 2 expanded authorities which allowed investments at purchase with ratings of BBB+ or higher. We also support the elimination of NIMs and CDOs as permissible investments for a corporate credit union.

704.6 Credit Risk Management

We support the inclusion of tighter sector concentration limits. While we have no suggested changes to the sector limits, we do have some comments on the single issuer concentration limits. The issuer limits of 25% of capital will be more restrictive than the sector limits given the limited number of issuers within certain asset classes, particularly in the top tier AAA-rated names. This might cause undue additional risk and investing lower on the credit curve as a result of forcing greater diversification in certain asset classes. While the proposed regulation tries to follow standard banking guidelines for its capital requirements, bank and thrifts, while recognizing they have very different asset make-ups from corporates, are not subject to sector concentration limits. This is in recognition of a financial institution's need to be able to manage some risk to achieve adequate earnings to meet capital requirements.

One can see the limitations caused by the single obligor limits of the proposed regulations using a basic balance sheet example. Take a $2 billion corporate credit union that may have a $100 million in total capital, they would be restricted to a specific ABS collateral group of $500 million while only allowed to invest $25 million per obligor. While this limitation may sound adequate, upon further review of the ABS universe you can quickly see this overall sector limit is well in excess of what is realistically available to invest on an obligor basis, especially in top-tier issuers. Because of this, the proposed regulation may significantly limit the investment options of corporate credit unions and may motivate some corporates to actually take additional credit risk in an effort to increase earnings and diversify by investing in lower tiered issuers/servicers. Two of the most popular sectors in the ABS space, credit cards and FFELP student loans, make this very clear.

In the ABS credit card sector, there are generally 6 top tier issuers: AMEX, CHAIT, CCCIT, DCMT, BACCT, and COMET. If a corporate invests in each of these top tier issuers at the proposed obligor limit, it would total $150 million which is well shy of the overall sector limit of $500 million. Since there would be $350 million remaining in allowable investments in this sector, some investors may look down the tiering curve to earn additional income. Issuers include smaller retail cards or small bank issuers, which may provide some additional incremental spread. However, they also contain more risks associated with less traded issuers/servicers such as less support of the program from the parent and generally a significantly weaker liquidity profile.

In the student loan sector, the lack of issuers is even more pronounced. In the FFELP arena, the sector is dominated by SLMA, while Citibank, Nelnet and PHEAA issue in smaller amounts. SLMA issues around 50% of the FFELP paper outstanding today. The same concept applies here: a very large sector limit which is significantly confined by the obligor limitations. Again, once a corporate reached their limits per obligor, most likely with SLMA, there would be limited availability of additional issuers in this sector. More importantly, the FFELP student loan sector is extremely popular because the collateral is essentially guaranteed and has remained extremely liquid because of its structure.

It was suggested by the proposed regulation that a sample corporate balance sheet could be made up of a percentage of ABS backed by private student loans. The example was not a realistic picture of a balance sheet structure or earnings potential for a number of reasons: (1) it shows that 100% were earnings assets, where this most likely will not be the case, (2) the spreads were at a point in time when the markets were still significantly stressed, where the spreads provided may not be attainable in normal market conditions (3) close to 50% of the 34 bps of earnings came from the large spread provided from the private student loan sector.

This example was troubling when you look deeper into this sector given its risk and lack of liquidity, to name a few. To start, SLMA is essentially the only issuer in this sector and in 2009, issued more than 90% of all private student loans securitizations (Citibank was the other 10%). Secondly, this sector is still in its infancy, so gathering credit data on projected losses, delinquencies, and credit enhancement support levels on these bonds is still extremely difficult. In addition, since there is no guarantee on these loans, an educated investor would want to dig deeper into loan level data, which at this point is not available. The ability to complete sufficient credit analysis on this sector is just not possible, even for the best analysts. This is the main reason why spreads on 3-year average life issues in this sector, which peaked at 1200 bps over 3-month LIBOR in early 2009, still remain at stressed levels around 400 bps over 3-month LIBOR. Spreads on other ABS sectors such as credit cards, FFELP-backed paper, and prime auto are slowly trending back to their late-2007 levels. The private student loan sector is extremely limited in terms of issuers, the liquidity profile is very weak, and credit analysis would not be adequate given the lack of data. It would not be recommended that any corporate move into this sector, especially given the credit environment we are experiencing today.

Although we understand the concern related to sector/obligor concentration, FCCCU believes the sector limits still remain excessively high. This doesn't seem to address the diversification issue that helped cause the current corporate crisis. Under our sample corporate of $2 billion in asset size with $100 million in capital, this would still allow up to $500 million in sectors such as RMBS, CMBS, and private-label student loan ABS. Due to obligor limitations, this would make managing a conservative corporate credit union balance sheet extremely difficult, especially given the earnings requirements detailed in the proposal. Not only taking into account the examples given above, but also trying to recognize relative value changes over time, this may necessitate or warrant higher investment limits in particular sectors than desirable.

<u>Recommendation:</u> ***Obligor limits are too restrictive and will actually create more credit risk as it forces investing in lower tier issuers. Obligor limits should be increased to 35% of capital to allow diversification within a specific sector limit.***

Another recommended change under the single issuer concentration limit is that fed funds/ overnight deposits should be allowed a higher concentration limit than the 25% of capital. A corporate credit union generally maintains large cash reserves given the make-up of its liabilities. Under the proposed limit, FCCCU would need between 25-35 counterparties to place our overnight deposits which would force us to place deposits into lower rated financial institutions. Currently, these deposits are primarily invested at US Central FCU or the Federal Reserve Bank although there is no assurance that these will remain viable options given either access or rate considerations.

<u>Recommendation:</u> ***Given the low risk profile of the fed funds/overnight market, we recommend that the single issuer concentration limit for overnight deposit transactions be increased to a limit similar to the aggregate repurchase limit for a single counterparty – 100-200% of capital.***

<u>704.8 Asset and Liability Management</u>

<u>Penalty for early withdrawals:</u>
Early redemptions of term certificates are currently subject to a market value gain or loss. The NCUA is proposing that early redemptions of certificate subject a member to either a book value payout or a market loss. Regardless of the value or term of the certificate, a corporate could not pay out anything above book value. This clearly is intended to make the certificate a lot less liquid and will deter additional investments in corporate certificates. There are numerous changes throughout the proposed regulation that limit the risk that a corporate may take which safeguards against member redemptions of certificates being a key to effective management of a corporate's liquidity. In addition, if a term certificate is directly matched by a similar asset, the transaction is managed and would allow corporate certificates to remain a viable portfolio tool for its member owners and allow for redemptions to take place based on market pricing. We believe this proposed change becomes punitive to the member-owners of the corporate and should be revised to be in line with current regulation that allows redemptions at a market based penalty. Since the corporate applies the market based penalty, it still has the option of setting a price that would discourage early redemptions as US Central FCU currently does with its FRAPs.

<u>Recommendation:</u> ***Term certificates redeemed by a credit union should be subject to a market based penalty – either a gain or loss -- as long as the corporate has the ability to divest its offsetting asset at a comparable gain or loss, whether or not the corporate actually sells the asset(s).***

Net interest income modeling:

We support the inclusion of NII modeling to project earnings under multiple interest rate scenarios. We also support the fact that there are no set parameters for NII so that the goal of the modeling is to help assess a balance sheet's risk to future earnings and allow management to make changes as it determines necessary to improve its projections. We believe this same principal should be applied to the new weighted average life testing contained within the regulation.

Weighted average asset life:

The proposed regulation calls for a weighted average life of a corporate's investment portfolio not to exceed 2 years, tested quarterly. Given the fluctuating nature of a corporate's balance sheet the weighted average asset life of an investment portfolio can change significantly throughout a month or quarter. A corporate's cash balances are extremely cyclical and can fluctuate significantly especially in the first quarter of the year. It would be extremely difficult for a corporate to stay within the 2 year target given the other restrictions within the proposed regulation. Most, if not all, corporates aggressively track liquidity and have historic member balance trends which help in the management of liquidity on the asset side of the balance sheet. To require the sale of assets to drop the WAL of the investment portfolio during seasonal periods of lower balances can be detrimental to the earnings capacity of the corporate. As a minimum we would recommend that similar to the capital calculation being based on 12-month average assets, the WAL portfolio limit should also be based on 12-month average assets so it takes into account seasonal inflows and outflows and allows a more orderly process for managing the average life of an investment portfolio. Also, we feel the 2-year weighted average life should be considered a target as opposed to a hard cap as managing a corporate balance sheet to a hard cap would be extremely difficult.

In addition, given the required testing for interest rate risk, the hard cap in average life doesn't allow a corporate to manage a dynamic portfolio during a variety of rate environments. Effective portfolio management calls for a variety of strategies for given yield curve scenarios. Placing a hard cap of a 2-yr WAL on the portfolio would not allow a corporate to effectively manage its balance sheet. Plus, to accommodate for potential fluctuations in balance sheet size a corporate would need to keep the WAL to about 1.5 years. A 3-year hard cap would allow a corporate the ability to more effectively manage a portfolio in the 2-year WAL range within an operating environment where the balance sheet size regularly fluctuates.

Recommendation: ***Allow the portfolio limit to be based on 12-month average assets which would take into account seasonal cashflows. If a hard WAL cap is desired, the cap should be extended to a 3-year WAL for the portfolio to allow some additional flexibility in managing assets and liabilities within a fluctuating balance sheet environment.***

Concentration limit per individual member:

The proposed regulation restricts the aggregate deposits from one member to 10% of a corporate's daily average assets (effective 30 months after the regulation is made final). We would recommend that rather than a hard cap, a corporate be required to track member concentrations and be required to match deposits in excess of 10% of assets from one member to the durations of the liabilities. For example if the member deposits are in overnight liabilities, the excess would have to be matched to overnight investments. This would allow a member to continue to fully utilize one corporate while the corporate would not be able to take additional liquidity risk on any deposits over the 10% concentration level. For clarification purposes, we would recommend modifying the calculation to be based on monthly average assets versus a daily calculation.

Recommendation: ***Corporates should be able to match deposits in excess of 10% from an individual member to the durations of the liabilities. Also, modify the calculation to be based on monthly average assets versus a daily calculation.***

Cash flow mismatch sensitivity analysis:

While we understand that many of the troubled mortgage bonds held by corporates were floating rate bonds, the reason for their troubles was not the fact that they were floaters but the fact that the underlying collateral had credit problems. This led to spread widening on these bonds which in turn created liquidity problems as credit unions started withdrawing funds from the system based on concerns regarding the creditworthiness of these mortgage portfolios. Given the much wider spreads, the bonds could not be sold without realizing large losses. Those bonds that ultimately did not have credit problems such as AAA-rated asset-backed credit card securities have seen spreads tighten considerably since the peaks in spread widening in late 2008. Other bonds that contain little to no credit risk component (government guaranteed & agency) did not see spreads widen significantly.

For example, government guaranteed SBA pools experienced very little spread widening leading up to 2009 and witnessed spreads widen for a very short time by only 75-100 bps, and only for a very short time. Even with this minimal spread widening, these assets could still be collateralized for borrowing during the liquidity crisis given the government guarantee. Agency floating rate pass-thru mortgages (7% caps) only experienced a maximum of 200 bps in widening shortly after the Lehman bankruptcy in late 2008, and averaged 79 bps since 2006. Agency pass-thru mortgages with a 7.5% cap experienced even less spread widening. Creating a 300 bps spread widening test across all assets does not incorporate the risks involved in each sector. As witnessed in the private-issued student loan ABS sector, spreads widened to over 1500 bps at its peak. More importantly, these bonds have always had a very poor liquidity profile.

The 300 basis point spread widening test with a target mismatch between assets and liabilities of 3 months completely dissolves the value proposition that a corporate can provide. By eliminating credit, interest rate, and liquidity risk the NCUA may have created a foolproof framework for corporates. However, it has effectively eliminated the ability to earn a return while providing a competitive product. Liquidity risk tends to be a by-product of other problems. Both credit and interest rate risk issues will eventually lead to liquidity problems. If during this recent crisis corporate balance sheets had consisted of generally government agencies or government guaranteed floaters, the credit union system could have easily managed through the liquidity crisis without causing huge losses to the credit union system.

***<u>Recommendation:</u>* Spread widening test should be modified to exempt securities that do not carry a credit risk component (0% credit risk weighting). In addition, assets risk-weighted at 20% should be subjected to a lower spread widening test (50-100 bps) than the proposed 300 basis point model to reflect their lower credit risk component.**

<u>Sample Balance Sheet Used in Preamble:</u>
The sample balance sheet used in the preamble that shows 70% of a corporate's liabilities in term deposits is not accurate. This may have been the case for US Central and Wescorp, but it certainly is the case for most corporates. The most that First Carolina has ever had in term deposits as a percentage of total liabilities was 50% and that was only for a short period of time. A more normal breakdown would be only 20-30% in term deposits. Given new restrictions for investing and risk-taking within the proposed regulation along with the need to control balance sheet size to meet capital targets, we would argue that a much higher percentage of liabilities going forward will be in short-term (90 days & under) deposits which more closely aligns with liquidity and settlement activities.

The preamble also contains a sample investment portfolio with spreads for assets taken at a specific point in time. Obviously, these will vary significantly. Three-year AAA-rated credit card asset-backed securities were trading at LIBOR flat prior to the financial crisis. If they get through the crisis without defaults which appears likely, their spreads could once again trend towards the more historical average around 15-25 bps over 1-month LIBOR. Spreads in general are wider now than they will probably be in 3 years across all asset classes based on the current market environment. The sample investment portfolio is also very dependent on 10% of assets being invested in private student loans ABS (LIBOR + 200 bps with 6 month WAL). As referenced previously in the sector/single issuer concentration section, a corporate who would want to invest in private issue student loans (a questionable asset class, especially in today's environment) would be very limited due to the shortage of issuers. Being in the middle of a severe credit event in the mortgage sector makes one question why we would want to be dependent on another asset class with potential credit problems that also contains difficult underlying collateral to analyze. It seems preferable to stick with higher asset quality investments and be able to take some measured liquidity risk. The proposed regulation likely would create the need to invest in lower credit quality assets (below AAA) in an attempt to purchase shorter-term bonds with some additional yield. If you look at corporates who did not have excessive private issue mortgage portfolios but took some liquidity risk during this downturn, none would have suffered losses that came close to wiping out retained earnings. With the regulation doing away with a "wholesale corporate," all corporate balance sheets should be far more liquid than they are today given that for the majority of corporates the major lack of liquidity rests with US Central's balance sheet. This will not be a factor in the future.

<u>Recommendation:</u> ***Re-model the effects of the proposed changes using more realistic liability percentages for overnight deposits and apply historical spread trends versus spreads***

taken at one moment in time. Our modeling of this regulation shows that we cannot possibly make sufficient earnings to meet the retained earnings accumulation goals required.

<u>50% slowdown in prepayment speeds:</u>
The proposed modeling of an assumption of a 50% slowdown of prepayment speeds is too simplistic and would be incorrect to apply to many asset classes. Most bond structures are not subject to slowdowns in prepayment speeds due to the relative short durations of their underlying collateral (auto loans). Modeling of mortgage-back securities (MBS) already incorporates a slowdown in speeds in a rising rate scenario where including an additional 50% slowdown in prepayment would be unnecessary. It also needs to be recognized that prepayment speeds will not change uniformly. In a rising rate/spread environment, speeds will change based on the economic incentive to refinance and will differ across a variety of coupons, terms and vintages. For example, a new 30-yr 7% MBS originated in 2008 will react differently than a seasoned 15-yr 4.5% MBS originated in 2003.

<u>Recommendation:</u> ***We recommend the assumption of a 50% slowdown of prepayments portion of the proposal be removed as MBS modeling already incorporates the impacts of prepayment speeds in a variety of interest rate environments. A generic 50% slowdown of prepayments would be difficult to model uniformly across a variety of coupons and structures.***

<u>Effective date of ALM revisions:</u>
There is no phase-in period for the ALM provisions contained within the proposed regulations.

<u>Recommendation:</u> ***We recommend a 12-month period of time before this section becomes effective to coincide with the effective date of the new capital standards.***

<u>704.9 Liquidity Management</u>

<u>Borrowing limits:</u>
The proposed change from today's borrowing authority of the greater of 10 times capital or 50% of capital and shares, to the lesser will drastically reduce a corporate's borrowing ability particularly in times of overall credit union system liquidity tightens. This proposed change will force a corporate to have a more liquid investment portfolio to reduce its reliance on borrowing when liquidity gets tight. While hurting a corporate's liquidity capacity, it at least does not necessarily negatively impact a corporate's earning capacity in the same manner the overall portfolio WAL limit and/or asset-liability mismatch limitations caused by the 300 basis point spread widening test. We would suggest that this is a more effective means of controlling liquidity of assets on a corporate balance sheet than a hard cap on a portfolio's weighted average life (2 years).

<u>Secured borrowings:</u>

The proposed regulation limits a corporate's borrowing to 30 days and allows non-liquidity related borrowings to an amount equal to a corporate's core capital amount that exceeds 5%. The 30-day term limit for borrowings not only negatively impacts a corporates ability to manage its balance sheet risks but also meet member borrowing needs. We would seek to eliminate the 30-day limit on borrowings for liquidity purposes and we would count a member credit union's borrowing as a legitimate liquidity purpose. To more effectively manage interest rate risk, corporates need the ability to match borrowing requests from member credit unions to borrowing the corporate may do to fund that request. Therefore, we recommend eliminating the 30-day term limit for liquidity purpose borrowings.

For the non-liquidity borrowing as allowed within the proposed regulation, we would also recommend eliminating the 30-day term as to participate in this type of borrowing a corporate will need to be well capitalized. At that point, a corporate should be able to use its limited authority to borrow for non-liquidity balance sheet purposes to better manage interest rate and/or liquidity risks which would generally involve longer than 30-day term borrowing to be an effective risk mitigation tool.

Recommendation(s): ***Eliminate the 30-day limit for liquidity purpose borrowings as long as the borrowing is directly matched off by a corresponding asset of similar term and structure. In addition, eliminate the 30-day borrowing limit for non-liquidity purposes since these borrowings are allowed only on the amount of capital a corporate has in excess of the minimum level to be categorized as "well capitalized."***

704.11 CUSOs

Permissible Activities:
The proposed regulation identifies only two approved services for a corporate CUSO – brokerage and investment advisory services. NCUA is aware of the range of CUSOs in which corporates currently have investments. We would recommend that NCUA add those services to the approved list of CUSO services for corporate CUSOs. If not, what criteria will NCUA use to determine appropriate services for a corporate CUSO? Should not control of this remain with a corporate and its members?

Recommendation: ***Add all previously approved corporate CUSOs to the NCUA's approved list of CUSO services for corporates.***

704.14 Representation

Term Limits:
The proposed 6-year term limits will result in a near complete turnover of FCCCU board seats as 7 of our 9 directors could not seek re-election under the proposed regulation. This appears to be a potentially very disruptive process to the governance of the corporate. In an environment where we have a shrinking number of credit unions and heightened concerns related to serving on a corporate board, it would seem like the term limits proposed may be a detriment to effective

board governance. The membership should determine whether term limits are appropriate and preferable.

<u>Recommendation:</u> ***Eliminate this proposed change or at a minimum extend the term limit to 9-years (3 three-year terms).***

<u>Chair Restriction:</u>
The proposed regulation continues to disallow the chair of a corporate board from simultaneously serving on the board of a trade association. This has been carried over from the days when corporate boards were interlocked with league boards. Given the clear separation of corporates from trade associations that exists today, we believe this restriction should no longer apply. We would continue to agree with the restriction that the chair of a corporate must be a representative from a natural person credit union member.

<u>Recommendation:</u> ***Delete the restriction that the board chair of a corporate cannot serve simultaneously on a trade association board of directors.***

<u>704.19 Disclosure of executive and director compensation</u>

<u>Annual Disclosure:</u>
For purposes of this proposed section of the regulation, we would recommend that the senior executive officer definition be restricted to the CEO and his/her direct reports. As a state chartered credit union, we already disclose executive compensation on our IRS Form 990 tax returns which are publicly available. The corporate credit union should have the ability to select its own format for disclosing this data to the membership.

<u>Recommendation:</u> ***For clarity and less reliance on job titles, senior executive officer definition should be restricted to the CEO and its direct reports.***

<u>Effective Dates for Transition</u>

There are numerous provisions of the proposed regulation that are effective immediately upon final approval by the NCUA board. Most, if not all, corporates will probably be immediately out of compliance with at least one or more of the proposed sections of the regulation. We would recommend there be some minimal amount of time given to comply with all sections of the new rules. Since most corporates are currently operating under an agreement with the NCUA in exchange for a NCUSIF share guarantee, it seems as if there would be minimal risk in providing an appropriate transition period for corporates.

<u>Summary</u>

There is no doubt that recent problems within the corporate system could have been minimized with tighter regulations and greater oversight. We are in agreement that we cannot allow the events of the last two years to be repeated. However, to allow a cooperatively owned corporate credit union to provide any real value to its members, it must be afforded some ability to manage risk. The proposed regulation essentially eliminates all risk a corporate could manage in providing products and services to its members. Under this scenario, we do not believe a viable corporate credit union is possible. We do believe the proposed regulation needs substantial revisions and with modifications can still safeguard the credit union system from the systemic risks it has suffered during the recent financial crisis.

If you have any questions regarding any of the items above, please contact me at (336) 217-4900 or dbrehmer@firstcarolina.org.

Thank you,

David W. Brehmer
President /CEO