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To: [Regulatory Comments](#)
Subject: Knut Hovde Comments on Part 704 Corporate Credit Unions
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Comments on Part 704 Corporate Credit Unions

I want to commend the NCUA and Board (collectively NCUA) for accepting comments and suggestions on improving these proposed new rules for the governance of corporate credit unions (CCU).

As the manager of the natural person credit union (NPCU), Share Advantage Credit Union, the impact of the corporate stabilization program and the impairment of our capital share deposits at Members United Corporate Federal Credit Union had a tremendous negative effect on our 2009 financial statements. Share Advantage Credit Union and the other NPCU will feel the continuing impact of this issue for the next several years.

My comments will be limited to the following areas:

1. Time to respond, or by March 9, 2010.
2. Future impact on NPCU.
3. Specific comments on Part 704

Item 1 - Time to respond. While I am able to respond within the prescribed timeframe, my comments are limited only to those areas of my concern, not the entire proposed rule.

The NCUA is undertaking a major revision to the supervision and operations of CCU. I believe that it is imperative to allow adequate time for CCU, NPCU and the rest of the credit union industry to review, analyze and provide comment on this important issue. It has taken me the better part of the past month to: first, read the entire proposal; second, re-read and highlight the areas of importance for my comments and suggestion; third, compare the proposed regulation with the current regulation; fourth, prepare an initial draft of my comments; and finally, review and submit those comments.

I am suggesting taking extra time to insure that we make this proposed regulation a document with which the credit union industry can be successful and grow, continuing to provide the necessary financial services to our members well into the future. The CCU needs time to develop an action plan to this proposal that rebuilds the confidence and trust of the NPCU. The NPCU needs to insure that, if it is going to recapitalize the CCU, that there are adequate rules and procedures in place to accomplish the objectives of the NCUA and the NPCU.

I am concerned that without the additional time to that process, we may end up with a regulation that is less than optimum. Therefore, I am suggesting that the NCUA extend the time for comment for at least an additional 90 days.

Item 2 – Future Impact on NPCU. I am concerned with these proposed changes as they regard the future impact on the financial statements of NPCU.

As it currently stands there are many investments in the CCU that have had their market value severely reduced due to the current economic downturn. The deterioration of these

assets may continue into the near future, causing additional impairment and further reducing CCU and NPCU equity. This proposed rule does not provide any guidance on those assets. In addition, these investments will take several years to recover enough economic value to be finally liquidated. Section 704.8(h) seriously impacts the ability of the CCU to hold these assets until they increase in value or mature.

In addition, I did not see any comment on what to do if these assets do recover in value. That economic value should be returned to the NPCU that has suffered significant losses due to instability of the CCU.

Item 3 – Specific comments on Part 704. The following are my specific comments and suggestions regarding this proposed rule by section number:

Section 704.3 – Corporate Credit Union Capital:

- a. Capital Requirements – Section 704.3(a): I believe that it is important for the NCUA to follow the BASEL Accords and comparability with the other federal regulators. I believe that the ratios proposed by the NCUA are appropriate and reasonable for the long-term success of the CCU and the credit union industry.
- b. Retained Earnings Accumulation Plan (REAP): While this is addressed in Section 704.3(a)(3), I suggest that the NCUA add a new section, or expand Section 704.3(a)(2) to include, a requirement that upon the passage of this rule that all CCU are required to have a REAP to show how they will be able to comply with these requirements and that it be updated annually until the CCU is documented as a “Well Capitalized” CCU or have demonstrated that they have achieved the capital requirements of Section 704.3(a)(1). I believe that this suggestion is important as it adds two important features to this proposal: 1) it provides a “benchmark” for the NCUA to monitor; and 2) it provides a mechanism for the NPCU to monitor and rebuild the trust that has been lost. I am hesitant to provide funds to re-capitalize the CCU without a clear analysis that the CCU can actually accomplish financial stability.
- c. 704.3(a)(3). Since the NCUA also has a six-year (1.00 basis point) and ten-year (2.00 basis point) benchmark for the retained earnings to moving daily average net assets, I would suggest that the NCUA also include language in this section to reflect those benchmark figures and similar reporting requirements.

Section 704.4 – Prompt Corrective Action: I believe that this Section is an important enforcement tool for the NCUA to insure the safety and soundness of the CCU into the future.

Section 704.5 – Investments:

- a. 704.5(f). I believe that change to “delivery versus payment” is appropriate and reasonable for the CCU.
- b. 704.5(h)(5) and (6). I believe adding these two prohibitions are appropriate and reasonable for the CCU.
- c. 704.5(j). I believe that this section should be expanded to direct the CCU to comply with Section 704.10 and develop an “Investment Action Plan” for any asset that is “grandfathered” after the adoption of the final rule.

Section 704.6 – Credit Risk Management:

- a. 704.6(c)(1). I believe the reduction of aggregate investments in any single obligor from 50% to 25% is warranted and reasonable for the CCU.

- b. 704.6(c)(2). I believe the addition of subparagraphs (ii) and (iii) and the elimination of the previous subparagraph (ii) are appropriate and reasonable for the CCU.
- c. 704.6(d). I believe that the addition of this subparagraph is prudent. CCU management needs to establish, evaluate, monitor and maintain practical investment limitations following the “prudent man” rule. This section provides management further guidance on those limitations. However, while I understand and appreciate the needs for maximum sector limits, I am concerned that the sections of those limits may still be still too high. I am particularly concerned with the long-term impact of these sector limits, which may cause management to misunderstand the risks of these securities and continue to place reliance on government backing, rating organizations, other guarantees of payment, or third-party insurance. In particular I am concerned that the market for student loans may not be suitable for CCU investment purposes. While the CCU is required under section 704.6(g) to document its justification for each approved credit limit, I would respectfully suggest that the NCUA initially make all sector limits be limited to a percent of capital as proposed by the NCUA. The percent of assets limitation portion of each sector should be allowed only for those CCU that are defined as “Well Capitalized” or who have demonstrated that they have the knowledge, qualifications and plans in place to manage such assets.
- d. 704.6(f). I believe the additional language added to this section is appropriate and reasonable for the CCU.

Section 704.8 – Asset Liability Management:

- a. 704.8(h). I am concerned that the requirement that the weighted average life of the investment portfolio may not exceed 2 years is not appropriate. While there are many factors that go into determining the average life of an investment and this calculation, from a safety and soundness perspective, this may not be long enough to adequately protect the CCU. I would defer to a professional accountant and professional investment advisor to determine an appropriate weighted average life requirement.

Section 704.14 – Representation:

- a. 704.14(a)(3). I am concerned about the proposed limitation of a Director for six years. On page 111 of the proposed rule the NCUA states: “*Sophisticated corporate investment and operation strategies require directors with adequate levels of knowledge and experience to understand and provide oversight for these strategies. NCUA believes that the recent crisis in the corporate system was attributable, in part, to a failure on the part of the some corporate boards to understand the extent of the risk embedded in their balance sheets.*” The following are my reasons for this concern:
 - 1) I believe that this severely limits the CCU in attracting and retaining qualified Directors to the senior management of only the largest NPCU as they are more active in additional investment activities that a CCU may employ.
 - 2) Why would the senior management of a smaller credit union want to take the time to learn the intricacies of CCU investment rules when they could only serve a limited amount of time? I for one would not want to spend that time.
 - 3) I further believe that this limits the individual Director as it takes time to fully understand the operations of a CCU and that by limiting the term to six years we will have a Director who has developed an understanding of the CCU and his/her experience will be lost. A Director is required to be part of an NPCU, and they have additional duties and responsibilities to that organization that need to be prioritized within their individual work schedules. I believe that the majority of the

Directors of the CCU are intelligent and try to serve with the best interests of the membership and industry. Their biggest failure was placing their trust in senior management, which actually made the investment decisions and failed to properly evaluate the investment risks.

- 4) A limitation of six years would place more emphasis on the qualifications and experience of senior management, who have no term limitations. While the Board of Directors has the overall responsibility for the safety and soundness of the credit union, it is senior management that actually conducts the daily operations of the CCU. A large part of our problem today is based upon the inability of senior management to properly evaluate the risks of the investments that they made, not the individual Director. These are the same individuals that the Board hired to provide the analysis and discussion of the risks embedded in the balance sheet. If there was a failure to understand, we need to recognize that it was the senior management of the CCU that failed to understand these risks. The Directors were at fault for not retaining senior management with the qualifications to manage the risks inherent to the CCU.
- 5) I believe that the proposed term limitation is not in the best interests of the NCUA and CCU and would respectfully suggest that the maximum term limitation be increased to not less than nine (9) years.

Thank you for your time and consideration of my suggestions.

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