From: Williams, Gary
To: _Regulatory Comments
Subject: Gary Williams" Comments on Part 704 Corporate Credit Unions
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Before I begin my comments regarding the proposed revisions to Part 704 regulating corporate credit unions, I would like to state my support for continuation of the corporate credit union system. Therefore from my perspective, any rules that are implemented should balance the mitigation of risks with a workable business model that will allow corporate credit unions to recover and thrive. First, I wish to commend the NCUA for the stronger overall capital requirements such as a base capital of 4%, concentration limits by investment sector to prevent risk concentration such as what occurred with mortgage-backed securities, tighter limits on single obligators, enhanced liquidity requirements, and prohibitions on certain higher risk securities. I believe those steps were necessary to address the mistakes that led to the problems we're dealing with today. Although I agree with many of the steps you have taken to reduce risk exposure, I believe the rule as proposed has gone too far in some instances in an attempt to eliminate almost all risk which, in turn, creates some unintended consequences.

Capital Requirements

The capital requirements are reasonable, but the timeframe to achieve those capital levels are not reasonable given the current state of the corporate system. Eighteen of the corporates have zero retained earnings and would face a significant challenge in meeting the 4% leverage ratio requirement within 1 year. The business model in which they would be required to operate under this proposed rule would also severely inhibit their ability to generate sufficient net earnings to build retained earnings. (more on that in a moment) Therefore, although the proposed rule does not *require* natural person credit unions to recapitalize the corporates - this extremely tight timeline to achieve 4% leverage ratio effectively compels corporates to seek contributed capital. We are then presented with the classic "catch-22". The corporates need the member capital, but the members will be very reluctant to put more capital at risk in a corporate credit union after having just seen their former member capital completely depleted by OTTI losses.

Many of the corporate credit unions are generating good net earnings, but are still dealing with write-downs of their legacy assets. Until legacy assets can be isolated, the corporates can't build retained earnings and natural person credit unions won't be willing to recapitalize. Assuming that legacy assets can be dealt with, then most of the stronger remaining corporate credit unions should be able to generate enough net earnings over time to achieve the 4% capital ratio without member capital contributions. Without continuing losses tied to legacy assets and with less risk within the balance sheet (thanks to the other proposed restrictions in Part 704), then corporate credit unions should be able to operate safely with lower net worth levels for the next few years. I would recommend that the rule be changed to allow corporates up to *3 years* to achieve the required capital levels.

I also believe the language dealing with contributed capital needs to be changed to state that contributed capital "may be available to cover losses" but not require that contributed capital be used to cover losses. GAAP allows an institution to carry a retained earnings deficit as long as the institution is an on-going concern. Several CPA firms have provided written opinions to that effect. Member or contributed capital would only have to be depleted in the event the institution is liquidated. This would protect contributed capital until or unless the corporate was liquidated. At the very least, capital investors should be allowed to share in the recovery of of capital if losses valued at the time a capital account is depleted turn out to be lower in the future than estimated.

Asset & Liability Management

The proposal establishing a maximum limit of two years on weighted average life of a corporate's aggregate assets and restrictive NEV benchmarks would not allow corporates to reward investors and generate enough return to be a viable business model. Several corporate credit unions have run models under the proposed WAL limitations and have concluded that they will not be able to generate sufficient net earnings to build capital (retained earnings) within the timeframe established in the

proposal. Corporates would have to significantly shrink their balance sheets which would impact their economies of scale. All financial institutions routinely have mismatched balance sheets - it is the primary method to create spread or net interest margin. A 2 year WAL is too short in duration to allow a corporate to attain an income stream sufficient to be competitive.

Corporate credit unions have typically been highly liquid. Natural person credit unions have supported the corporate system during this crisis by flooding the corporate credit unions with liquidity. Duration risk and interest rate risk should not be an issue at this time. The greater issue was credit risk and concentration risk - which has been adequately addressed in this proposal. But taking away all liquidity risks & interest rate risks creates the unintended consequence of low net earnings and an unworkable business model long-term. I would recommend that you remove all limitations on specific weighted average life requirments and instead address this issue solely through NEV requirements. However, I would not place heavy reliance on a 300bp shock test - but instead apply a 100bp shock test applied to both sides of the balance sheet and raise the acceptable parameters for changes in NEV to higher levels. There are many methods to manage interest rate risk other than placing extreme limits on duration.

The other unintended consequence of squeezing a corporate's lifeblood (net interest margin) is that it will force the corporates to seek other sources of income or cut services. Most likely that would mean raising fees, charging higher rates to borrow or use services, eliminating low margin services, etc. If corporates are forced to take that approach because their business model has been restricted, then much of their value to natural person credit unions goes away.

Concentration Limits

The prohibition from having a single member or entity make up more than 10% of daily average net assets also creates unintended consequences. It would inhibit corporates' ability to generate business. Corporate balance sheets are driven in part by the level of liquidity at their member credit unions. For very large credit unions experiencing sharp growth, it would not be unusual to see their deposits at a corporate suddenly exceed the 10% level. Corporate asset size is very volatile and this restriction limits the capacity of corporates to borrow. I suggest that this limit be removed or raised to a much higher level - or exclude the Federal Reserve, FHLB or Fed Funds from the equation.

Board Make-Up & Compensation Disclosures

Limiting board members to CEOs, CFOs or COOs of credit unions eliminates a wealth of smart, experienced individuals who could contribute greatly to governance. There may be some very talented volunteer directors at member credit unions who would make excellent corporate directors. There may be other individuals within the filed of membership of the corporate who would make good directors. On the other hand, there are many individuals who hold the title of credit union CEO, CFO or COO who probably don't have the expertise to govern a billion dollar institution that deals with investments or services that their own credit unions have never used. The title is not important - the skills, background & education levels are the key. I would eliminate the current requirement based on a job title and instead, allow directors from anywhere within the FOM who meet certain skill and educational requirements. I also would not put a term limit of 6 years on the directors. It is difficult enough to find good volunteer directors - and when we find one who is strong, capable and contributes we want to hold on to them for as long as possible. Instead, perhaps provide a method for removing directors based on cause - but remove term limits.

I also disagree with the requirement that compensation of each senior executive officer and director be disclosed annually. Frankly, most corporate credit union members don't care and applaud well-deserving executives for being paid fairly. Disclosing directors' pay (assuming that directors' compensation would only be from their "real" jobs) also has no bearing on corporate performance and would discourage potential directors from seeking a position on a corporate board. I doubt seriously that executive compensation created the problems in the corporate system. However, the proposal does forbid golden handcuffs for executives when the corporate is in conservatorship or receiving NCUSIF assistance. I would place another restriction on bonuses and simply prohibit the payment of bonuses or incentive compensation in the event that the corporate has a negative ROA.

Legacy Assets

I realize that this proposal is not designed to repair and restore the current corporate system but is designed to create a system for how corporates should operate in the future - but until the problem with legacy assets is addressed there will be no future for corporate credit unions as proposed. No natural person credit union will be willing to recapitalize a corporate credit union that is still holding billions of dollars in legacy assets that continue to be at risk for OTTI losses. If natural person credit unions won't recapitalize, then corporates will not meet the capiral requirements of the revised Part 704 and the restricted business model as proposed will not allow them to generate enough earnings to build retained earnings. Soon all corporate credit unions will go into PCA and that will be the beginning of the end for the corporate system. This entire rule-making process will be a waste of time until the issue of legacy assets is addressed once and for all.

I strongly encourage NCUA to come up with a plan to isolate legacy assets and announce that plan soon. It has been suggested that NCUA could seek permission to borrow from the CLF to move those legacy assets from the corporates to the Corporate Stabilization Fund. There those legacy assets could be held to maturity and it is very possible that losses will not be as great as were projected. Plus, the corporates have already written down a large portion of the value of those legacy assets so future exposure to the stabilization fund will be relatively lower. As OTTI writedowns occur, the NCUA could assess special premiums to the corporate credit unions to cover those losses and repay the borrowings over a 7 - 8 year period. If at all possible, those premiums should only be assessed against the corporate credit unions and not natural person credit unions. I don't know if my suggestion is feasible, but regardless of the method used, the legacy assets must be removed from the corporate balance sheets and natural person contributed capital must be protected from future OTTI losses.

Thank you for the opportunity to comment and I sincerely hope that NCUA will create a more balanced Part 704 that still allows a corporate credit union to operate a viable business model while mitigating the real risks.

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