February 24, 2010

Delivered Via email regcomments@ncua.gov

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

Re – Proposed Regulation 12CFR Part 704

Dear Ms. Rupp,

I would like to thank you for the opportunity to provide my perspective and comments on the proposed Regulation Part 704. In addition, I would like to thank the NCUA for the many steps taken to preserve our industry during the severe issues, which surfaced during the Global meltdown.

While I understand the NCUA's need to improve oversight of the Corporate Credit Union (CCU) industry, I will never understand how regulators feel that they can take the "risk" out of doing business by writing hundreds of pages of regulations. The real affect of these decisions are added business costs, which may or may not provide additional safety and soundness to an institution and more importantly the Share Insurance Fund.

Preamble

I have read, listened in on Webcasts and attended the San Diego Town Hall meeting. The principle that "this will never happen again" was prevalent and appears to have been so scripted in the Proposed Regulation 704. With that said, I do not possess the expertise to evaluate each section and propose solutions. However, experts do exist that have not been actively engaged in this process. These experts are the diligent, intelligent, and hard working management teams from 25 of the 27 CCU's. These management teams truly did care about Safety, Liquidity, and Yield; and all their natural person credit union members. I do hope that this comment period gives the non-conserved CCU management teams an opportunity to be truly heard.

In all the materials and presentations by the NCUA, a statement has always been made, "let us not look to place blame, but focus on moving forward". I would agree with that statement, but the concept of not analyzing where and how the two conserved CCU's got to this point appears to be lacking in the new regulation. The new regulation appears to eliminate the Corporate System. It sure is a good thing that NPCU's do not take the same approach to our mistakes. If we did, lending would cease to our members after the first charged off loan. I would encourage the NCUA to withdraw the proposal in its entirety and begin with correcting the issues that caused the situation.

The hot topic for the past two years is "collaboration". A perfect example of collaboration is the Corporate System, as it was established due to the high cost, poor service for-profit bankers in which NPCU's once did business with. It has been estimated that the new regulations will cost CCU's and thus NPCU's, ranging in assets size of $50 to 250 million in assets, in the range of $30 to $70 thousand dollars per year. Our other choice will be to look at the for-profit sector. The costs of this choice will be similar, as each institution will have to manage several organizations, adding staff expenses and bank fees. With or without the Corporate system, as the new regulation is written, our already small margins are going to be eroded further.

Comments Regulation 704

Corporate Capital

In general, increasing the Corporate Industry's capital is a good idea and having three ratios may be an improved way to measure. In the regulations current form, the accumulation of capital as described appears unnecessary and an impossible goal to achieve.

Using the new regulation, there appears to be very little risk, as running a matched book of business needs less capital. Based on accumulating 200 basis points of retained earnings after 10 years, a 4% leverage ratio, a 4% risk-based Tier 1 ratio, and an 8% minimum risk-based total capital ratio is operationally unreachable, as well. The NCUA should be required to have independent testing of the prescribed business model.

Another concerning area is the powers granted to the Director of the Office of Corporate Credit Unions. If I understand, Section 704.4 based on ratings given during an exam or at the discretion of the Director, the capital category can be lowered. If the capital category is lowered, than the Director can use the Powers over Undercapitalized Corporates and exercise some severe actions. All these powers granted to one individual, without checks and balances, appear to be a dangerous path to head down.

The "Legacy Assets" that have been discussed recently have not been addressed in the regulation. These tainted investments may or may not cause additional losses within the industry. I know our credit union would not be willing to recapitalize a Corporate without the new capital being excluded from losses associated with these investments.

There would be Capital within the system, if not for the methodology being imposed by the NCUA. The heavy hand of the NCUA to force the extinguishment of capital based on estimates of future losses, through one company's model, is not a requirement of

GAAP accounting. GAAP requirements suggest that multiple vendors, including internal management assumptions, be used to determine the estimated losses.

Accounting practice does require the recognition of these estimated losses but does not require the extinguishment of capital. The CCU's can and should be allowed to operate with negative Retained Earnings. Other financial institution regulators are allowing this methodology and the Chairman of the Financial Accounting Standards Board has publicly supported this method of handling the estimated future losses, until cash flow losses occur.

Modeling Flaws

I have seen and been presented with information concerning NCUA's corporate business model of how CCU's can achieve 21 basis points. Serious flaws exist with the asset mix assumptions, lack of cost of capital, and the choice of "Private" label student loans.

The model shows 30% in overnight and 70% in term investments. The historical averages of a CCU are more in line with 50/50 or 70/30 overnight to term, as one of the main functions is to provide liquidity to NPCU's. This appears to be an improper assumption to add additional income to the bottom line.

The lack of placing a cost on capital is not going to occur.

The largest concern is the choice of placing 10% of the total assets in "Private" label student loans. I am no expert, but today is it not the "Private" label Mortgage Back Securities that are causing the greatest losses! Now the NCUA is recommending that CCU's place 10% within an unsecured asset back security. To top that, at supposedly 200 basis points above LIBOR. These assets do not exist at those spread levels. If they did, how much risk is in those pools? A majority of the MBS agency pools were purchased at LIBOR plus 30 and non-agency plus 40 to 50.

It should be required that an independent third party review the model placed before us. A report should be shared (transparency) with the credit union community discussing the probability of achieving the 21 basis points, the risks associated with the model and investment choices.

ALM/INVESTMENTS

The Cash Flow testing in ALM models already decreases prepayment speeds, as rates increase. The additional 50% decrease in prepayment speeds on top of the models programmed decrease, is unrealistic and illogical. The ALM models are more likely to accurately predict prepayment speeds, as the models individually view each investment based on the coupon rate. Is the 50% some arbitrary number that was selected or is it based on some historical evidence?

The limitations in the weighted average life of 2 years are too restrictive for an institution to make the spread needed to be profitable.

Concentration limits in the proposed single obligor area will increase the costs of monitoring multiple relationships. At a minimum, for terms under 90 days this limit should be increased greatly from the 25% of capital or $5 million.

I would recommend these sections be rewritten.

Board Governance

Limiting the term of a CCU volunteer to six years will increase the risk to the Share Insurance Fund. The CCU is a different animal in comparison to NPCU's. To be an effective volunteer, it takes time to gain sufficient knowledge of the workings of CCU. It also takes several years to gain sufficient knowledge to lead committees (ALCO) and to work ones way through the ladders to one day become accountable as a Chair. This area is one that had zero impact on the crisis, but appears to be more of a social project. If a board is function at a high level, why place a term limit?

Should outside directors be allowed? The expertise may be of value. At what cost? Would these people not have the same interest as the for-profit board members? It was the for-profit world which caused this crisis and these boards were full of experts.

Executive Compensation

Would disclosure of an executives pay program have eliminated the Global Meltdown? The public held banks and mortgage organizations that caused this situation have their compensation disclosed in SEC filings. Therefore, it appears this did not eliminate risky behavior. Will this insure additional safety and soundness of the institution or the share insurance fund?

Golden Parachutes are a different animal. I believe that executive compensation plans should be allowed, as there are many deserving senior level managers. In addition, the programs should allow attracting and retaining quality individuals. There should be a limitation placed on these plans and that they are not paid out when the individual has been involved in the demise of the CCU or when the employee is released due to negligent behavior.

Future:
I would request that the NCUA review the cost benefit of every new regulation. Has the NCUA or other government agencies considered that over the past ten years all the regulations have added 10's of thousands to 100's of thousands of dollars to our operating expenses? Is it possible that the additional regulations have placed our country's financial system at risk? Increased expenses equal increasing risks to cover the costs.

Will the same format be used to limit all risk in Natural Person Credit Unions? In case this division of the Federal Government has missed the past two decades, job growth is created in this country by small business. I would encourage that there is a bigger picture than ensuring "this will never happen again". As in its current form, Regulation 704 appears to potentially eliminate the Corporate Network and will drastically affect NPCU's, to a point of the elimination of hundreds if not thousands of NPCU's.

Is it the NCUA or other government agencies wish to eliminate small and midsize institutions? All actions have reactions, many of the reactions occur without forethought during origination. I am sure that during the repeal of Glass Steagall, no one thought of that, a Global meltdown would occur, caused by aggregation of these "too large to fail institutions". It was the largest institutions in our country that caused the crisis and in our industry it is the largest causing the losses. Why then are we attempting to eliminate the Corporate industry, which may cause thousands of small and mid-size institutions to merge? Someone needs to be looking at the big picture. I hope that will come from the NCUA Board.

Simple Solutions
What are the core reasons this all occurred? In my preamble, I stated that solutions are found by studying what occurred and correcting the issues. In my opinion, National Fields of Membership and Expanded Investment Authorities were the root of the problem. When the NCUA granted these authorities, the "greed" kicked in and one particular Corporate needed to be the biggest.

Why not work with the Credit Union System to develop 10 to 12 regionalized Corporates, similar to the Federal Reserve System. Competition to take each other members was and will continue to be the problem unless corrected. In the investment arena, pull back the investment authority levels. Corporate CU's served the Credit Union Community well without the expanded authorities.

Sincerely,

Steve Kelly
President/CEO