



February 24, 2010

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

Dear Mary,

This letter is written by and represents the opinions of the Travis Credit Union executive management team and Board of Directors. Given the state of the Corporate Credit Union system and the benefits that its continued existence affords to the credit union system as a whole, we appreciate the opportunity to comment on the NCUA Board's recently proposed changes to 12 C.F.R. Part 704 and related provisions.

This regulatory overhaul aims to reduce the risk in the corporate system, not only to avert a repeat of the recent problems encountered in the corporate system but also to anticipate new problems which might occur as stated in the preamble to the proposed regulation. NCUA's objectives are laudable and may make some sense in the wake of the economic turmoil; however, the extent of these restrictions, both individually and in their totality, raises serious questions about the ability of the corporate system to operate profitably going forward.

We are concerned these rules do not just affect the Corporates – they affect most credit unions. Currently Travis Credit Union utilizes corporate credit unions to provide a variety of services:

- Payment processing – share draft processing, electronic transaction processing and settlement
- Liquidity management – borrowing
- Investment management – short, medium and long-term investment products and services
- Consulting services – interest rate risk analysis and management

Should the rules become final in their current state, there will likely be a serious disruption to the services provided to Travis Credit Union. The corporate credit union we rely upon will be restricted in its ability to offer attractive and safe yields on investments and products and services at a competitive cost. The impact to our credit union will be:

- Costs associated with developing, distributing and analyzing requests for proposal on payment processing and/or consulting services previously provided by the Corporate;
- Costs associated with converting to a new provider;
- Impact associated with training staff and new service providers;



- Loss of liquidity options and increased hesitancy to re-capitalize if Corporates are restricted in their investment offerings;
- Harm to the cooperative movement as services are migrated from Corporates to banks or other non-credit union service providers.

As an industry there is a serious risk that natural person credit unions (NPCUs), particularly small-sized credit unions, will face lower yields on corporate deposits, very limited loan products, increased costs from fees associated with payment systems, potential changes in other product offerings and fewer competitive investing options, in both short and longer term deposit options.

Some estimate that enacting these rules in the current form would cost NPCUs \$18 – \$23 million in lost income annually, at a minimum. Most of the increased costs would likely be borne by the small and medium-sized credit unions since the larger ones may have better options and better negotiation leverage. As the larger credit unions seek alternatives to these cooperative models of co-ownership, the costs will go even higher for the small and medium credit unions. Given that over 95 percent of NPCUs use the Corporates, there is little doubt that such an outcome would weaken not only NPCUs, but the cooperative credit union system as a whole. These regulations could force NPCUs to go back to seeking investment, liquidity and payment system options from banks, brokers, Wall Street firms, and other profit-seeking intermediaries.

### **Proposed Changes Potentially Detrimental to NPCUs**

#### **704.6(c) and (d) Concentration Limits**

As written, Federal Funds transactions are not specifically excluded from the sector concentration limits. As a result, Corporates would have severely limited access to the federal funds market. This will have the harmful effect of reducing the overnight rates which member credit unions receive from their Corporate. To address this we recommend that the definition of deposits in 704.6(d) be amended to include Federal Funds or, alternatively, that the exemptions from sector concentration limits include Federal Funds transactions. Also, we further recommend that 704.6(c) be changed to allow a larger single obligor limit of 200% capital on money market transactions with a term of 90-days or less. An alternative solution might be to specifically allow a single obligor limit of 200% of capital for Federal Funds transactions sold to other depository institutions.

Such fixes will better position Corporates to invest short term liquidity at reasonable rates which, in turn, will enhance overnight rates which NPCUs receive.

#### **704.8(c) Penalty for Early Withdrawals on Corporate Certificates**

This proposed provision limits a Corporate's ability to pay a market based redemption price to no more than par, thus eliminating the ability to pay a premium on early withdrawals. Such a change will pose a significant disincentive for member credit unions seeking liquidity and will likely lead NPCUs to seek more competitive investing options beyond Corporates. As a result Corporates' institutional funding market for term certificates will be severely impaired, or even



wiped out, which will lead to a significant reduction in overall liquidity in the corporate credit union system. Therefore, we urge the Board to strike this proposed requirement from the final rule as it will detrimentally impact NPCU investment options.

#### **704.8(e) and (f) Average-life NEV Testing**

The proposal requires average-life mismatch net economic value (NEV) modeling/stress testing in addition to existing interest rate risk NEV modeling. We are concerned by analyses which indicate that there is no combination of assets – with a two-year average life and limited extension risk – which could generate sufficient margin to attract funding and pass a 300 basis point credit shock test. Further, the proposed limitations placed upon a Corporate by these tests would not allow Corporates to generate sufficient interest margin to build retained earnings to meet the new capital requirements contained in the proposal. Any ability to generate a reasonable interest margin in order to build retained earnings will become dependent upon a lower cost of funds for Corporates which will result in a lower yield paid to NPCUs.

#### **704.8(h) Weighted Average Asset Life**

This provision limits the weighted average life (WAL) of a Corporate's aggregate assets to two years, and includes loans to members. Such a requirement will have adverse implications for NPCUs seeking to fill liquidity needs with term loans from Corporates. In order to keep the overall WAL of its portfolio within the two year limit, most of the loans made by Corporates will be limited to shorter-term maturities. For longer term loans Corporates will have to substantially increase the rate offered in order to compensate for the impact the longer term will have on its two year WAL test. As a result, long-term financing to NPCUs will be drastically reduced and will come with a much higher borrowing cost. This will force NPCUs to seek less beneficial or more expensive funding from other sources. Therefore we encourage the Board to exclude loans from the calculation of WAL of the investment portfolio.

#### **704.8(k) Limit on Business Generated from Individual Credit Unions**

Under 704.8(k), a Corporate would be prohibited from having a single member or entity make up more than 10 percent of its moving daily average net assets. While well intended, this restriction could negatively affect the Corporates' short-term borrowing ability as well as the options the NPCUs can choose. Corporate balance sheets can fluctuate by as much as 25 percent of assets within a month and, as such, short-term borrowing is extremely important. The current limit of 10 percent may force a Corporate to accept less favorable terms regarding price, maturity, and collateral, which could increase cash balances, thus negatively impacting both earnings and their service to NPCUs.

#### **Other Concerns**

We urge the NCUA to consider the erection of a more robust buffer between the Corporate's risk and NPCU safety. We suggest that the NCUA consider the creation of a separate insurance fund or separate insurance "system" for Corporates in the future.

While we are aware that NCUA has made public statements indicating that it will announce plans in April 2010 for addressing legacy assets, we are puzzled as to why this critical topic is



not mentioned at all in the proposed rule. Dealing with investment securities remaining on Corporates' books is vital to realizing any lasting, consequential changes to the corporate system. These assets—by some estimates believed to represent as much as \$30 billion in eventual losses or one-third of all natural person credit union net worth—continue to create instability in the network, and serve as a major disincentive to credit unions providing any future capital contributions. No investor will invest unless the toxic assets are segregated so that new capital is not at risk. We believe that failure to address this issue invites the weakening of even currently stable Corporates, and would serve to negate the positive changes that NCUA and credit unions would like to see in the Corporate system.

### **Conclusion**

These proposed regulations, in their current state, create serious issues which must be addressed. Any one of these new rules on its own has the potential to cause a major change to the operations of the Corporates; together they will threaten their very existence. If these rules were enacted as proposed, Travis Credit Union will be forced to seek services from sources outside of the Corporate system.

In closing, Travis Credit Union would like to thank the Board for the opportunity to provide the views, concerns, and recommendations of natural person credit unions on the Agency's unprecedented action. We urge the Board to seriously and respectfully consider our opinions and requests, balancing the immediate needs of the Corporate system with the long-term needs of the entire credit union industry. At this pivotal point in our industry's history, it is imperative that we take action that secures solutions not only for today's problems, but also tomorrow's prosperity. We are confident that credit unions can count on responsible, yet bold, leadership from the Board.

Sincerely,

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- c: Patsy Van Ouwerkerk, President & CEO Travis Credit Union
- c: Travis Credit Union Board of Directors
- c: California Credit Union League