March 2, 2010

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

Re: Proposed Regulation 12 CFR Part 704

Dear Ms. Rupp:

I appreciate the opportunity to once again provide input to the NCUA Board regarding our Corporate Network by commenting on the proposed revised regulations that govern corporate credit unions. Although the proposed regulation is directed at the nation's corporate credit unions, ultimately, this regulation will affect almost all natural person credit unions. As NCUA has indicated, over 95% of all natural person credit unions have accounts at a corporate credit union and as you know, many of these credit unions depend heavily upon the services offered by their corporate. In my state, all credit unions have a relationship with their corporate and they're viewed as one of our critical strategic partners.

I believe there are some major limitations in the proposed rule that cause me a number of concerns, mostly over the additional required ALM testing that may directly limit my access to liquidity sources and lower my investment returns. If not amended, these parts of the proposed rule will force my credit union into the undesirable position of seeking alternative, possibly far more costly, and certainly more unreliable, providers instead of a corporate credit union that I and other credit unions have owned and supported for over fifty-nine years. I do not want to go through that process. I do not want to do business with entities that we compete with on a daily basis, and don't have my best interest in mind. This regulatory proposal, as drafted, will ultimately force natural person credit unions into doing business at the will of for-profit financial services providers that have significantly greater risk exposure than even our current corporate system.

Furthermore, it is short-sighted on behalf of a Federal regulatory body to assume that a one-size fits all or a tightly consolidated corporate credit union system could possibly serve the needs of NPCUs. The losses sustained are not the result of an insufficient regulation, or insufficient experience at the board of director level, or even insufficient ALM modeling.

Here are my primary concerns:

704.8 Asset Liability Management

In general, I would comment that I believe in response to the crisis that the corporate system experienced and the associated costs to the credit union industry, NCUA has implemented new regulation to ensure that the stated mantra of "never again" was overachieved. The additional spread testing, mismatch limitations and the two-year weighted average life maximum on top of the currently required NEV testing represent a layered regulatory framework that is overly restrictive.

In my own opinion, the same objective of "never again" could've been achieved with additional regulation that improves credit and asset concentration limits, combined with a reduction in investment authorities. No one, from Wall Street professionals to credit union CEOs, foresaw the breakdown that lead to the economic crisis of the past couple of years. Despite all of this additional regulation, we can most likely be assured that no one will foresee the next crisis that will impact the entire U.S. economy, corporate credit unions and the credit union industry.

704.8 (e)(1)(i) Credit Spread Widening

I know that my corporate uses floating-rate investments to limit interest rate risk by allowing them to move the rates they pay us quickly when interest rates change. This additional test eliminates the value of these safe investments and essentially converts them to fixed-rate investments for measurement purposes. As a result, almost all of the assets on my corporate credit union's balance sheet would be considered fixed-rate for measurement purposes and we all know that a large majority of their funding comes from overnight investments. Therefore it would be difficult for my corporate, and I'd assume all corporate credit unions, to be in compliance with the proposed regulation simply based upon this one additional test. It makes little sense to me that we would penalize corporates for holding securities with this very risk adverse floating rate component. Will I be required in the future to perform the same modeling on my floating rate HELOC's that we view as a positive risk management tool?

Why 300 basis points spread widening? Is that based upon historical averages or the worst case ever scenario? We've been told that historical analysis indicates that 100 basis points would be a highly unusual and rare event.

I recommend that NCUA consider two changes to this new testing requirement. Limit the spread widening test to 100 basis points and either eliminate or take into consideration a scaled spread widening based upon the risk-weight of the asset. For example, if the asset is an agency floater, then the spread widening test should be less severe than if the asset was a non-agency mortgage backed security.

704.8 (h) Weighted Average Life (WAL)

The proposed WAL of two years is unnecessary given the current rigid Net Economic Value (NEV) requirements that already capture this risk. This will most likely limit the ability of my corporate to provide longer-term investment and liquidity options. My corporate has always been helpful in working to accommodate whatever investment or liquidity maturity I need or desire. If I want a three-year term investment and my corporate can match that liability with a three-year term investment – why should my corporate be penalized for that even though they have not taken on any additional interest rate risk? Why should my credit union be penalized (either in the absence of product availability, or in the form of less than advantageous rates) for wanting an investment or loan greater than two years from my corporate?

I recommend that the WAL of two years be eliminated from the regulation based upon the fact that the risk is already captured in other ALM tests that the corporate is required to comply with.

704.8 (f) Cash Flow Mismatch Analysis

This analysis subjects all amortizing investments to the same slowdown in prepayment speeds despite the fact that historically, non mortgage prepayment speeds don't change as much as mortgage-backed securities. This would represent a "double whammy" if actual prepayment speeds have already slowed down and additionally, the test doesn't consider the unique coupon rate of the actual underlying collateral and the impact that has on prepayment speeds.

I recommend eliminating this test and rely on the periodic analyses already provided for in Section 704.8(d)(2)(ii). As another alternative, this test should only be applied to the prepayment speed of mortgage-backed securities and not for non-mortgage holdings.

Ability/timeframe to meet Leverage Ratio

If none of the above ALM testing requirements are revised, I doubt that any corporate credit union could design a business model that would generate sufficient earnings to build their capital at the pace required to meet the benchmarks for the new leverage ratio requirement.

If today's current interest rate environment were to persist and many economists believe that it will, the periodic benchmarks for the retained earnings portion of the leverage ratio may be unrealistic for corporates to achieve. It will be especially difficult since the majority of corporates are starting from zero retained earnings due to the depletion of their capital investments at U.S. Central or losses on their own holdings. NCUA should know how difficult it is to build retained earnings from zero due to your experience with low-income designated credit unions. Consider additionally, that the majority of net interest income for corporates is generated from a balance sheet that consists primarily of investments and not loans.

I recommend additional time to achieve the periodic benchmarks for the retained earnings portion of the leverage ratio to the following: four years for 0.45%; eight years for 1.00% and twelve years for 2.00%. This still represents a significant challenge for any corporate credit union to build that level of retained earnings.

Replenishment of Member Contributed Capital

I can't emphasize enough that NCUA should allow for some mechanism in the new corporate regulation where corporates can return capital back to existing capital holders if actual losses on investments in which OTTI has been taken are less than projected. Regardless of how many experts model the projected losses, nobody knows exactly what the losses are going to be when all is said and done. I know that the ACCU and CUNA have proposed mechanisms that would facilitate the ability to recapture that lost capital. This needs to be included in the final regulation, and corporates should not be prevented from replenishing capital if actual losses are less than expected and the corporate has meet all regulatory capital requirements. Why should any other entity benefit if losses are less than what was paid for upfront based upon your loss estimates?

704.3 (d)(3) Standards for determination of appropriate minimal capital requirements

This section allows for a subjective judgment to be used in determining a corporate's capital status regardless of whether or not they meet the capital standards as defined in the regulation. I'm concerned that if I choose to invest in a perpetual capital account at my corporate, and they are consisting meeting the periodic benchmarks for building retained earnings, one individual at NCUA can still make a subjective determination that different and potentially higher capital standards are required for my corporate. (Having served three years as an NCUA Examiner I all too familiar with this scenario.) Based upon that decision, NCUA could potentially then merge my corporate (and my capital) with another corporate that I'm not willing or interested in supporting. As written, the regulation does not identify the methods by which NCUA will ensure consistency in its approach to this subjective measurement.

Under the proposed regulation, the OCCU Director can arbitrarily increase the capital required for a corporate; can unilaterally require that certain capital accounts be discounted and not included in applicable capital ratios; unilaterally change the capital category of a corporate; and lower a corporate's capital designation if only one of many CRIS categories are rated a 3 or lower. Why write a 254 page regulation with capital standards and benchmarks documented and in place and yet give the OCCU Director massive latitude to basically ignore the requirements at anytime for any reason? Is the OCCU Director always going to be the one that makes this decision? It seems to me that I remember some discussion only a year or two ago about eliminating the OCCU at NCUA. What happens if the OCCU is eliminated? Who then makes these decisions? This gives too much power to one individual and at the very least the NCUA board should have to approve any type of decision regarding the change of a corporate credit union's capital designation. There is likely no need to discuss the lack of credibility within the OCCU staff – considering there were full-time resident OCCU examiners on staff at both Wes Corp and US Central and that the WES Corp SVP/CFO since 2003 came from that dept.

I recommend the subjective judgment of determining the appropriate capital requirement for a corporate credit union be removed from the regulation and the appropriate capital level designation should be based upon the calculated capital ratios only.

704.9(b) Borrowing Limits

This section places a limitation of 30 days on liquidity borrowings. I understand that in the past, some corporates may have leveraged their balance through borrowings and taken on additional risk, and I agree that practice should be restricted. However, I also believe that the issue has been addressed with the new capital requirements and it would be unlikely that any corporate would purposefully leverage their balance sheet anytime in the near future. This restriction does eliminate a valuable asset/liability tool for corporate management, and increases liquidity risk to corporates if another crisis eliminates the ability of a corporate to roll 30-day borrowings.

This borrowing restriction seems interesting and perhaps counter to the NCUA goal of ensuring that corporate's are liquidity providers as they were originally conceived to be. We want them to be liquidity providers but we are going to limit their borrowing for liquidity purposes to 30-days. In seems odd to me that our lender of last resort, the Central Liquidity Facility, borrows and lends for a minimum of 90-days but we're going to restrict the system liquidity providers to borrowings of 30-days or less. This restriction be removed from the regulation as it could prevent corporate credit unions from fulfilling a key function that we rely heavily upon and due to the fact that this should be restricted under the NEV testing limitations anyway.

704.14 Board Representation

I believe that the proposed term limits for directors of six consecutive years is too short of a time for the following reasons: a corporate's operation is significantly different than a credit unions, and it takes some time to thoroughly understand; it will put greater pressure on corporate management to be potentially shifting priorities based upon a board member's desire to accomplish things quickly during their term; and in smaller states like ours, the pool of potential volunteers is limited. I'd recommend lengthening the term limit for consecutive years served to nine or eliminating them altogether. Let the election process work for itself.

704.8 c Penalty for Early Withdrawal

This section eliminates the ability of a corporate to redeem an outstanding certificate at a premium price. This would partially eliminate the current attractiveness of a corporate certificate because it would eliminate my ability to turn that asset into cash when needed. If I can sell my marketable security at a gain, but not my corporate certificate, I'm most likely going to choose the marketable security as my investment of choice. This is a different decision than in the past, as I normally would've chosen the corporate certificate. As a result, I think this would place my corporate at a competitive disadvantage and reduce their longer term deposits. This will cause them to rely more heavily on short-term and overnight deposits which will make their funding costs more volatile and perhaps impact their ability to meet my liquidity needs. My recommendation is to leave the current rule as is for certificate redemptions and if necessary, define a mechanism for how a gain should be paid.

The above areas comprise my major concerns with your proposed rule, and I hope that my comment on this is sufficient to prompt you to reconsider these proposals in the ways I have indicated.

I do hope that NCUA is sincere in their desire to listen to the comments and allow the over 7,000 credit unions to determine how they want their Corporate Network to look, and allow them to determine what products and services are wanted and needed from our corporate. I've heard the NCUA Chair state at the recent NCUA Town Hall meeting in Dallas that "twenty-eight corporates are far too many for our system". Does NCUA truly have an open mind regarding the future of the Corporate Network or is a pre-determined plan already in place? A comment like this makes me wonder if the NCUA Board has the view that 7,000 credit unions are too many to serve American consumers?

It is very clear to me that NCUA has put a lot of time, thought and consideration into this proposal and that you intend to strengthen the Corporate Network by eliminating risk so that it can be of lasting value to all credit unions. However, we cannot eliminate all risks and a corporate must take some risks in order to provide value to my credit union.

I want to see my corporate be given every opportunity to continue to provide valuable services and products to my credit union and continue to be my strategic partner into the future. I hope that my comments, along with those of my fellow credit union leaders, will assist you in structuring regulation to allow that to happen.

Sincerely,

Mahlon P. McCaleb
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