

From: [DeAnn J. Straub, President / CEO](#)
To: [Regulatory Comments](#)
Cc: league@ccul.org; chrisc@ccul.org; ritaf@ccul.org; dstraub@kernfcu.org
Subject: Comments on Part 704 Corporate Credit Unions
Date: Tuesday, March 02, 2010 8:51:21 PM

Date: 03/02/2010

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

Subject: Comments on Part 704 Corporate Credit Unions

Dear Ms. Rupp:

On behalf of Kern FCU, I appreciate the opportunity to comment on NCUA's proposed amendments to Part 704, which would make major revisions regarding corporate credit union capital, investments, asset-liability management, governance, and credit union service organization (CUSO) activities.

Firstly, on behalf of the Board of Directors, volunteers and executive management team of Kern Federal Credit Union I wish to thank the NCUA Board for the opportunity to comment on the above-referenced proposed regulation regarding re-structure of the corporate credit union system. While we agree with many of the considerations included in the proposed regulation, we have significant reservations regarding some of the limitations that would severely impact the ability of corporate credit unions to continue to offer services to natural person credit unions such as Kern Federal Credit Union.

We are supportive of the NCUA's efforts to reduce the risk in the corporate system and we recognize the NCUA's objectives of addressing the recent problems in the corporate system. However, we believe the restrictions included in the proposed regulation raise critical questions regarding the ability of the corporate system to operate profitably going forward.

Kern Federal Credit Union is deeply concerned that if the proposed regulation is left unchanged there will be severe, and possibly unrecoverable, repercussions to corporate credit unions. Further, we are concerned these rules do not just affect corporate credit unions but most natural person credit unions as well.

Currently Kern Federal Credit Union utilizes corporate credit unions to provide services including payment processing, investment management, liquidity management and a variety of other services including interest rate risk analysis and management.

Should the rules become final as currently written, 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 potential impact to our credit union includes; increased costs associated with developing, distributing and analyzing requests for proposal on payment processing and/or consulting services previously provided by the corporate; increased costs associated with converting to a

new provider; increased costs and possible decline in service levels associated with training staff and new service providers; the loss of liquidity options and finally increased hesitancy to re-capitalize if corporates are restricted in their investment offerings. While these negative outcomes impact Kern Federal Credit Union specifically, they may also impact the cooperative movement as a whole when services are migrated from corporates to banks or other non-credit union service providers.

Our critical issues of concern are as follows:

Recapitalization of Corporate Credit Unions

Firstly, the one-year time period for capital ratio attainment, as currently written, would appear difficult to achieve given the current economic environment. Corporates would be required to acquire new capital or at least convert existing MCA to PCC during a period when the issue of legacy assets remains unresolved. Secondly, we recommend that the proposed rules clearly set out the rights of member capital in the event of unrealized losses. Shouldn't member capital owners deserve the chance to recover a pro rata share of their capital if unrealized losses do not exhaust member capital? We believe that the liability for future losses must be addressed as a prerequisite to recapitalization.

Finally, if a new corporate system is developed, net worth standards must be adequate to cover the risks in the balance sheet. Any capital standards should be risk-based. Most financial institutions use risk-based net worth standards to assure adequate net worth to offset balance sheet risks. Credit unions would be well advised to adopt risk-based net worth as the basis for net worth standards.

Concentration Limits

As written, Federal Funds transactions are not specifically excluded from the sector concentration limits. Should this remain unchanged, corporates will be severely restricted in their ability to invest in short-term liquidity at reasonable rates. This in turn will dramatically reduce the overnight rates natural person credit unions receive from corporates.

I ask that the NCUA consider a number of revisions: Change the definition of deposits in 704.6 (d) to include Federal Funds, or include Federal Funds transactions in the exemption from sector concentration limits. Also, please change 704.6 (c) to allow a larger single obligor limit of 200% of capital on money market transactions with a term of 90-days or less.

Such an approach will better position corporates to invest short-term liquidity at reasonable rates, which, in turn, will enhance overnight rates which natural person credit unions receive.

Penalty for Early Withdrawals on Corporate Certificates

This proposed provision caps the market-based redemption price to no more than par, essentially eliminating the ability to pay a premium on early withdrawals. Such a change will most likely cause natural person credit unions to divest from corporates in favor of more competitive investing options outside the credit union system. This would most likely result in a significant reduction in liquidity in the corporate credit union system. Therefore, we urge the Board to remove this proposed requirement

from the final rule.

Average-life NEV Testing

The limitations resulting from these tests as proposed would not enable corporates to generate sufficient interest margin to build retained earnings to meet the new capital requirements contained in the proposal. We are concerned by analyses which indicate that there is no combination of assets with a two-year average life and limited extension risk that could generate sufficient margin to attract funding and pass a 300 basis point shock test. The proposed regulation would impart a requirement upon corporates to lower their cost of funds which will result in a lower yield paid to natural person credit unions.

Weighted Average Asset Life

This provision limits the weighted average life (WAL) of a corporate's aggregate assets, including loans to members, to two years. Such a requirement would severely impact natural person credit unions seeking to address both liquidity needs and interest rate risk with term loans from corporates. As a result, long-term financing to natural person credit unions will be drastically reduced and will come with a much higher borrowing cost. Clearly this would motivate natural person credit unions to seek long-term liquidity financing outside the credit union system. Therefore we encourage the Board to exclude loans from the calculation of WAL of the investment portfolio.

Limit on Business Generated from Individual Credit Unions

Under 704.8(k), a corporate would be required to limit a single member or entity to comprise no more than ten percent of its moving daily average net assets. This may force a corporate to accept unfavorable terms regarding price, maturity, and collateral, which could increase cash balances, thus negatively impact both earnings and service levels to natural person credit unions. While well intended, this restriction would adversely affect corporates' short-term borrowing ability and subsequently limit the ability of natural person credit unions to earn acceptable rates on overnight investment positions. We recommend the NCUA consider moving this cap upwards to 25 percent of its moving daily average net assets.

Corporate Credit Union Service Organizations

The proposed regulation includes a short list of permissible CUSO activities. Further, the proposed regulation provides for broad access by the NCUA to CUSO books, facilities and activities. We find this section ambiguous. As previously stated, Kern Federal Credit Union relies on corporates and CUSOs to provide a variety of services. Accordingly, we ask for greater clarity and information to be included in the regulation regarding corporate CUSO activities.

Other Concerns

We urge the NCUA to consider adoption of a more pragmatic firewall between corporate (and systemic) risk and natural person credit unions. We suggest that the NCUA consider the creation of a separate insurance fund or separate insurance "system" for corporates in the future.

Conclusion

Clearly these proposed regulations, as currently written, create serious issues which must be addressed. While any one of these new rules individually has the potential to cause a major change to corporate operations and their financial health, collectively they may jeopardize the very existence of the corporate network. If these rules were enacted, Kern Federal Credit Union would be forced to seek services from sources outside of the corporate system at great cost to the credit union and our members.

In closing, Kern Federal Credit Union would like to thank the Board for the opportunity to comment on the Board's proposed regulation. That being said, we respectfully urge the Board to seriously consider our comments and requests, balancing the immediate needs of the corporate system with the long-term needs of the entire credit union industry. We are confident that together the NCUA, corporates and natural person credit unions will resolve these serious issues facing our industry today and ensure a viable credit union system for the future.

Thank your for your consideration to this critical matter.

Sincerely,

DeAnn J. Straub, President / CEO