From: Greg Krause, Senior Vice President, CFO
To: _Regulatory Comments
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Subject: Comments on Part 704 Corporate Credit Unions
Date: Thursday, March 04, 2010 8:21:55 PM

Date: 03/04/2010

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 Orange County's Credit Union, 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.

By way of background, Orange County's Credit Union (OCCU) is a California state chartered credit union with assets of $917 million and a membership base of 78 thousand. The credit union has been a long-time supporter of Wescorp FCU and the corporate network system. In addition to being a member of Wescorp FCU, we also have member capital accounts with Southwest Corporate FCU and Members United Corporate FCU. Over the years, we have truly appreciated the payment systems and ALM Net Economic Value validation services provided by Wescorp and the investment services provided by the three corporate credit unions. Obviously, we were very surprised when NCUA took conservatorship of Wescorp and upset about the Wescorp PIC and MCA impairments at all three corporate credit unions. To date, our PIC and MCA impairments amount to $10.7 million.

While we have incurred large losses, we understand the important role corporate credit unions provide and want a vibrant and financially sound corporate network system for the future. We recognize that the NCUA Board and staff have spent an enormous amount of time, effort, and consideration in researching, discussing, soliciting and evaluating input, and creating the Advanced Notice of Proposed Rulemaking and this proposed rule. NCUA's desire to improve and strengthen the corporate system is evident in the scope and breadth of this proposal. However, we feel there are several provisions that, if enacted as proposed, will make it essentially impossible for corporate credit unions to operate in a viable fashion. Further, many of these provisions will have harmful effects on natural person credit unions and, ultimately, impact OCCU.

At a recent NCUA Town Hall Webinar, NCUA asked that our comment letter assume that corporate credit union balance sheets do not include any legacy assets that are likely to take additional significant losses. Our comments below are based on that assumption; however, we are concerned that the timeframe may be inadequate between the still uncertain implementation of a legacy asset solution and the corporate recapitalization effort.

Prior to delineating our areas of concern, we do want to point out what we feel are positive changes in the Proposed Rule. Those changes include: (1) stronger capital requirements; (2) concentration limits by investment sector; (3) tighter limits on single obligors; (iv) limited subordinated securities restrictions; (5) enhanced liquidity requirements; and (6) prohibition on certain higher risk securities.

Listed below are our primary areas of concern regarding the proposed rule changes and proposed recommendations.

(1) Penalty for early withdrawals on corporate certificates
This proposed provision limits a corporate credit union'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. We feel this provision will put corporate credit unions at a serious market disadvantage and may ultimately lead to a significant reduction in overall liquidity in the corporate credit union system as natural person credit unions choose to place their excess funds elsewhere. Unintended consequences of this provision include (i) to push term certificates off a corporate's balance sheet; (ii) to reduce the corporate's access to a more stable term funding source; and (iii) to reduce the corporate's ability to provide lines of credit to its members. If implemented, OCCU would definitely look at other more advantageous market options to place its excess liquidity.

Recommendation: We strongly urge the Board to strike this proposed requirement from the final rule, as it is not only counterproductive to maintaining corporate liquidity and natural credit union investment options, but would likely have long-lasting and harmful effects to the system.

(2) Retained Earning Growth Model
After obtaining feedback from various corporate credit unions and the CCUL, we are very concerned that the NCUA's assumptions regarding a corporate's ability to grow retained earnings under the proposed investment and ALM limitations (pages 99-101 in the proposed rule), do not represent a reasonable and attainable mix. We believe the proposed model violates principles of concentration risk, represents too much exposure, and is far-removed from attainable, real-world results. Specifically we find three major issues that are associated with the Sample Portfolio used in the Proposed Rule.

First, the Sample Portfolio allocates 10 percent of the model investment portfolio to private student loan ABS. It is our understanding that this investment type is a fairly risky, extremely illiquid, and has a very limited market supply. Attaining a 10% allocation in this sector appears unlikely even if it made financial sense. In addition, the model assumes a spread of 200 basis points over LIBOR for this investment type. We feel a more realistic market spread would be LIBOR plus 25 basis points. Based on this, it appears to us that the income projected from this type of investment is overstated and unrealistic.

Second, the Sample Portfolio fails to account for the cost of member-contributed capital. It is very unlikely that OCCU would recapitalize any corporate credit union without a competitive market return.

Third, the model assumes funding using a deposit mix of 30% overnight shares and 70% certificates. This assumption is not valid, as other provisions of the proposal (e.g., the early withdrawal premium provision for certificates) will serve to create a major disincentive for corporate term funding

Recommendation: NCUA provide independent, third-party "proof of concept" validation of the Agency's business model presented in this proposal or any alternative proposal. A proper assessment must do more than just "test the math." A credible assessment will test the assumptions and ultimate viability of the proposed business model.

(3) NEV Sensitivity Analyses
The proposal requires average-life mismatch net economic value (NEV) modeling/stress testing, in addition to existing interest rate risk (IRR) NEV modeling, to include:

• A 300 basis point credit spread widening, coupled with a NEV ratio decline limited to 15 percent;
• A 50 percent slowdown in prepayment speeds to determine if the corporate has excessive extension risk; combined with
• A portfolio/asset limit of two years in average weighted life.

Based on feedback from various corporate credit unions, we are very troubled 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 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. We commend the NCUA for addressing the NEV sensitivity issue but feel the NEV limitations in the proposed rule are too stringent.

As currently written, the weighted average life (WAL) limitation includes member loans in the calculation. We fear the result of this will be long-term financing to natural person credit unions will be drastically reduced and will come with a much higher borrowing cost.

Recommendation: NCUA amend the NEV sensitivity test to a 100 basis point credit spread widening and a 35 percent NEV volatility tolerance limit. With regards to the portfolio WAL, we ask NCUA to exclude loans to members from the WAL calculation of the investment portfolio.

(4) 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. We feel this will have the harmful effect of reducing the overnight rates that we will receive at our corporate. In the current economic environment, every basis point of income is important.

Recommendation: 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% of capital on money market transactions with a term of 90-days or less.

(5) Board of Director Qualifications and Term Limits

The proposal requires that all board of directors hold a CEO, CFO or COO position at the member institution and that a director's term be limited to six consecutive years. While we support allowing only senior level executives at member institutions to serve on the Board, we are of the opinion that a particular job title does not necessarily make for a better board member. We feel that consideration be given to an individual candidate's overall knowledge and expertise, rather than simply to the candidate's current job title. With regards to term limits, we support the concept of term limits but believe the proposed six year term is too short. We feel that a maximum of nine years provides a more reasonable and useful time for training and developing directors as well as for benefiting from the investment in their development. Extending the term limit to nine years further allows for much needed continuity for a corporate without compromising the benefits that may be realized from bringing on new directors

Recommendation: The NCUA eliminate the requirement that would limit board candidates to those currently holding the position of CEO, CFO, or COO and instead charge a corporate's nominating committee with the responsibility of establishing detailed criteria for the expertise of board members. We recommend that NCUA change the term limit from six years to nine years.

In closing, OCCU thanks the NCUA Board for the opportunity to provide our concerns and recommendations regarding this very important rulemaking. As previously stated, we feel having a financially sound and viable corporate credit union network is vital to the long-term success of the credit union industry.

Thank your for your consideration to this critical matter.

Sincerely,

Greg Krause, Senior Vice President, CFO