From: John McKenzie
To: _Regulatory Comments
Subject: Indiana Credit Union League"s Comments on Proposed Revisions to 12 CFR Part 704 - Corporate Credit Unions
Date: Thursday, March 04, 2010 1:33:55 PM

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

Via E-Mail: regcomments@ncua.gov

Re: Indiana Credit Union League's Comments on Proposed Revisions to 12 CFR Part 704 - Corporate Credit Unions

Dear Ms. Rupp:

The Indiana Credit Union League (ICUL) appreciates the opportunity to provide comments on NCUA's proposed revisions to the agency's Corporate Credit Union (CCU) regulations. The ICUL represents 179 of Indiana's 199 credit unions with those credit unions' memberships totaling more than two million members.

We recognize the importance of revising the CCU regulations, and appreciate NCUA's outreach efforts through Town Hall Meetings to receive as much input from natural person credit unions (NPCU) as possible for consideration in developing the final rule. Given the magnitude of this situation, its impact on credit unions, and the significant changes the regulation will create in the corporate credit union network, it is important that NCUA not rush this rulemaking process. We believe that time is our ally. The true losses associated with the legacy assets will not be known for years. The true losses corporates will have to book will not be known for years. Given these considerations, we believe that NCUA should proceed very cautiously with requiring changes that will have a negative impact on credit unions, and should allow as much time as possible for better information to be available about the legacy assets.`

The following provides our perspective on the proposed rule.

Legacy Assets

We believe that it is imperative that NCUA finalize the plan to segregate the legacy assets from the corporates' balance sheets as soon as possible. We understand that NCUA is addressing this issue outside of the proposed regulation, and the preamble to the proposed corporate regulation asks that it be considered assuming "clean balance sheets." We find this is very difficult for credit unions to get past, and it clouds the process of reviewing the proposed rule. Until this issue is resolved, it is going to be very difficult for credit unions to view recapitalizing the CCUs any way other than too high a risk. Many NPCU boards have told their management to "not to invest another dime" in CCU capital. Recapitalization of the CCUs needs to be discussed in an environment not tainted by the legacy assets.

We encourage NCUA to complete development of the plan to deal with the legacy assets as soon as reasonably possible, and re-issue or extend the comment period on the proposed corporate regulation once this is completed. This would allow for a fairer review of the proposal. We also believe that any plan developed for dealing with the legacy assets needs to include a methodology, should the actual losses be less than projected, allowing credit union capital accounts that have been written off to be replenished based on the better performance of these assets tied back to a credit union’s prior capital investment.

We are concerned that the other federal financial institution regulators have been more flexible than NCUA in the treatment of troubled assets, and their impact on the financial institutions’ balance sheets. It is imperative that NCUA not place the credit union movement at an unfair disadvantage by applying different methodologies that negatively impact the CCUs balance sheets, and as a result, the NPCUs balance sheets in a way that is inconsistent with the approach being used by other regulators.

Approach to capital at CCUs

We believe that the proposed regulation does not provide a mechanism for credit union recapitalization of CCUs in a way that credit unions will feel comfortable putting additional funds at risk. The legacy assets that have resulted in the OTTI losses are not addressed in the regulation. Again, it will be hard to get credit unions to recapitalize when they know that the existing OTTI charges will continue to be expensed by CCUs, and that new levels of OTTI losses could be expensed each quarter, requiring additional capital write-offs. NCUA needs to provide a mechanism for credit union capital investments to not be subject to write-off for some period of time.

Additional mechanisms for absorbing future OTTI losses on the legacy assets being explored also need to be finalized in such a way as to allow CCU balance sheet assets to be lower, thereby reducing the capital needed to meet capital standards. However, NPCUs continue to believe that should the losses associated with the legacy assets be less than anticipated, NCUA should allow for credit union capital accounts that have been written off to be replenished based on the better performance of these assets tied back to a credit union’s prior capital investment. It has been particularly frustrating to NPCUs that NCUA requires those with assets greater than $10 million to follow GAAP, but then NCUA applied a different standard when it came to the capital accounts NPCUs held with CCUs. If GAAP is the standard, should it not be applied consistently?

While the capital levels appear to be reasonable, the requirements for CCU capital, including 100 bp in retained earnings within six years, does not appear reasonable, especially with the legacy assets still out there. NCUA’s “sample corporate balance sheet” that would accomplish this is not realistic, and some of the assumptions related to capital expense and income generation appears flawed. The third-party modeling that NCUA is using to validate the ability of a CCU to meet the capital requirements under the proposed rule should be released and should include the assumptions the third party used in the modeling. Again, if the results of this third-party modeling will not be available until close to the comment deadline, we would encourage NCUA to extend the comment period to allow for interested parties to review the results of this modeling. We believe that in order for a CCU to reach the retained earnings targets under the proposed regulation, it will likely have to increase fees and lower rates, which would likely result in services and investments not being competitively priced and NPCUs will look elsewhere for services.

CCUs will need more time to reach the capital levels required by the regulation. Much of the regulation assumes that credit unions will be willing to recapitalize the CCUs to the 4% level immediately, and then CCUs will only need to focus on reaching the retained earnings requirements. This is not a realistic assumption.

Ability for CCUs to be a very attractive product/services option for payment systems/settlement/liquidity services

Natural person credit unions rely on CCUs for payment systems, settlement, and liquidity services. The final regulation needs to be structured in a way that does not result in CCUs being put at an unfair disadvantage to provide these services on which credit unions rely, especially small and medium-sized credit unions.

We are concerned that the capital requirements, weighted average life (WAL) of all assets not exceeding two years, and more restrictions on CCU borrowings to meet liquidity needs could result in lower rates and higher fees to credit unions. This could also reduce the length of term a CCU is willing or able to make term loans, or it could eliminate CCUs as an option for term loans all together.

Limiting the CCUs' aggregate borrowing to the lesser of 10 times capital or 50% of capital and shares (currently it is the greater of these) is overly restrictive, especially during the time period that CCUs are building capital from virtually zero. This could force CCUs to liquidate assets at inopportune times to raise liquidity. The emphasis over the past 18 months has been to hold on to the legacy assets to avoid a fire sale and the resulting losses. This new lower limit on borrowings appears to put CCUs at risk of a fire sale on assets should credit unions look to invest elsewhere.

As emphasized in the proposed regulation, liquidity management is an important area to measure and test. The final rules need to provide CCUs with flexible tools that support the management of liquidity, and not be so restrictive that selling assets becomes a major liquidity management tool.

The investment services role for CCUs

We believe that a two-year WAL for all assets is unrealistic, especially with the increased emphasis on mismatches in terms between assets and liabilities; it should be dropped. The various shock tests already in place, along with the addition of a credit shock component should be sufficient to monitor risk without placing such narrow limits on CCU assets. Limiting the WAL to just two years will result in credit unions needing to invest outside of CCUs. This could result in credit unions investing directly in securities that they do not fully understand; needing to increase expenses associated with ALM in order to properly evaluate and manage new investments; and smaller and medium-sized credit unions having more limited options due to the size of the investments required to go direct to some of these sectors.

Concentration limits by both sector and single obligor are important; however, this issue is influenced by the investment options available to CCUs. It is important that the limits established do not encourage over-emphasis of one sector over another to the point of being counter-productive or forcing CCUs to bid against each other and drive down the rates in order to meet unrealistic concentration limits. The single obligor limits are too restrictive and would force CCUs to invest with obligors they might otherwise avoid in order to meet the needs of their ALM and credit unions. The single obligor limits could result in CCUs exposing themselves to higher risks than they would normally, because they would have limited the number of obligors they would consider investing with, but under the proposed rule, would not be able to invest enough in the higher quality obligors.

A lot of NCUA's analysis on the ability of CCUs to meet the new capital requirements relies heavily on student loan ABS. Is this market really large enough to meet the needs of CCUs if all invested to the maximum sector limits for these types of ABS? It also does not appear that NCUA used realistic spreads on private student loan ABS in the pro forma analysis showing the ability of CCUs to meet the capital requirements. How this area is handled in the third-party modeling being done for NCUA needs to be disclosed, and it should include an analysis of the size of this market relative to CCUs' investment needs. Also, if this market is this attractive to CCUs, will NPCUs also look at these investments directly, further driving up the prices of these securities? The proposed WAL, and comments made by NCUA that for CCUs, investments should be third in priority, will reduce the investment offerings CCUs will be able to make available, forcing NPCUs to consider these alternatives.

The proposed regulation's elimination of the ability of CCUs to redeem certificates early at a premium is viewed as counterproductive and should be dropped. NCUA has encouraged credit unions to maintain deposits with CCUs. Removing this feature from CCU certificates will make them less competitive and could result in credit unions investing in more competitive investment securities elsewhere.

Is it necessary to limit investments in a CCU by any one depositor to 10% of the CCU's assets? This limitation does not exist for credit union investments in other depository institutions. As long as the credit union does its due diligence, why place this type of limit on them? This could result again in credit unions moving deposits elsewhere, resulting in CCUs needing to liquidate investments for liquidity purposes.

<u>CCU Governance/Other</u>
We believe that a term limit for CCU directors of six years is too short. Term limits of nine or more years would better equip the CCU to maintain a knowledgeable and well-qualified board. The frequency of turnover with a six-year term limit would not allow an individual to serve long enough to experience the various cycles that CCUs go through, and to be able to provide insight into how the CCU can navigate the various cycles. The limitation of eligibility to serve on a CCU board to individuals holding the tiles of CEO, COO, or CFO does not by itself ensure the individual is knowledgeable enough to serve on the board, and also eliminates individuals who may be very qualified but do not have the necessary title within their credit union. We believe it would be more inclusive to use "senior management" of a NPCU as the requirement, not specific titles.

Limiting indemnification of senior management and directors will result in otherwise well-qualified individuals choosing not to serve because of potential concerns over risk to personal assets. It is important that the best qualified individuals be encouraged to serve on CCU boards, not be discouraged.

Given term limits and a board made up of only natural person credit union representatives, there are already enough checks and balances in place where a CCU should not have to proactively distribute compensation information to the entire membership annually.

Thank you for the opportunity to comment on the proposed revisions to the proposed CCU regulations.

Sincerely,

John McKenzie

John McKenzie
President
Indiana Credit Union League