Kansas
CORPORATE CREDIT UNION

March 5, 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:

We appreciate the opportunity to once again provide input to the NCUA Board regarding the proposed revised regulations that govern corporate credit unions. As background, Kansas Corporate Credit Union (KCCU) is a state-chartered corporate that was formed in 1951 as the first corporate credit union that served only credit unions. We've always had a national field of membership, but we primarily serve credit unions in Kansas and the neighboring states. Every Kansas credit union has a relationship with KCCU and we are considered by many members as their most critical strategic business partner.

First, we believe it's important for the NCUA Board to recognize that, like individual credit unions, each corporate is different – the management and membership for each have a different philosophy and needs. In Kansas, we've had fierce legislative battles with the banking industry, so members of KCCU have taken their duties of ownership seriously and instructed KCCU management to provide the services necessary for them not to have to rely on their for-profit competitors for financial services. As a result, we have a high market share for liquidity, investment and correspondent services. Many of our members have no relationship with a banking competitor and less than a handful are direct members of the FHLB system or the Federal Reserve Bank.

This has been achieved, despite as NCUA has frequently told us during the examination process, that KCCU is a conservatively run corporate. Both the philosophy/beliefs of KCCU management and the demands/needs of our membership over the years didn't require KCCU to engage in many of the activities that the proposed regulation is designed to negate. Therefore, we believe KCCU can be successful in the future and that our membership will be supportive. What we've heard in the Town Hall meetings that we conducted throughout the state in February, is different than what you've heard in your Town Hall meetings, or at the breakout session at this year's GAC. Our members are supportive, still want to control their own financial system, and are not willing to cede control and go back to doing business with their for-profit competitors – which is the only option available to the majority of our membership due to asset size and geographical limitations.

We do appreciate and want to recognize the efforts of NCUA to draft proposed regulation to address areas that contributed to the losses incurred by corporate credit unions over the recent years. This includes implementing risk-based capital standards, improving retained earnings levels, limiting investment authorities, and applying more appropriate concentration limits. However, we do feel that the proposed regulation also contains sections that are too restrictive, and could prevent KCCU from either providing the services that our members/owners demand from us, or not provide us with the ability to generate the necessary income to build our retained earnings at the pace specified in the proposed regulation.

We believe there are some major restrictions in the proposed rule, mostly over the additional required ALM testing, that may directly limit KCCU's ability to provide liquidity sources to our members and competitive

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investment returns. If not amended, these parts of the proposed regulation may force our members into the undesirable position of seeking alternative, possibly far more costly, and certainly more unreliable providers instead of taking advantage of the very entity that they own. Here are our primary concerns:

704.8 Asset Liability Management

In general, we believe that the credit 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. We also believe that the proposed additional ALM testing requirements should take into consideration the credit quality (risk-weight) of the assets owned by each corporate.

In our opinion, NCUA's 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. The additional ALM requirements primarily address interest rate risk, which have been well managed by corporate credit unions and didn't cause the problem that lead to losses in the corporate system. Credit risk, which eventually lead to the liquidity issues, is what we believe caused the financial crisis experienced by corporates and this risk isn't addressed with additional ALM tests that by themselves may be appropriate, but when taken together could be in conflict.

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

We have utilized floating-rate investments to limit our interest rate risk, earn slightly higher additional yield than overnight investments which allow us to pay a competitive rate to our members in all types of interest rate scenarios. This additional test eliminates the value of these safe investments and essentially converts them to fixed-rate investments for measurement purposes. The credit spread widening of 300 basis points is required of all floating-rate investments without any regard to the credit quality of the issuer of that investment. As a result, almost all floating-rate assets would be considered fixed-rate for measurement purposes which would cause KCCU, and most likely all corporate credit unions, to fail the test of a maximum Net Economic Value (NEV) change of 15%. The spread widening test coupled with a decline in NEV limited to 15% is too restrictive and will severely hamper any corporate credit union's ability to generate sufficient earnings.

We believe, and recommend, that the proposed revisions should include a scaled spread widening test that is based upon the risk-weight of the underlying asset. We believe it makes good sense to carry the risk weight assigned to the asset (under the risk-weighted capital requirements) to the ALM testing sections and take into account the credit quality of the asset. For example, if the asset is an agency floater, then the spread widening test should be less severe (100 basis points) than if the asset was a non-agency mortgage backed security (300 basis points). Historical analysis would indicate that a 100 basis points credit spread widening on most assets would be a highly unusual and rare event.

704.8 (h) Weighted Average Life (WAL)

We believe that the proposed WAL of two years is unnecessary given the current rigid NEV requirements that already capture this risk. If a corporate is mis-matching short-term liabilities with longer-term assets inappropriately it will be, and has been proven, to be captured in the current NEV testing. The two-year WAL requirement will most likely limit the ability of KCCU to provide longer-term investment and liquidity options to our members. We have always worked our best to accommodate whatever investment or liquidity maturity our members need or desire – it's one of the features that our members value in KCCU. This will hamper our ability to be flexible in our product offerings.

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We would 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 required. If a hard cap for WAL is deemed necessary by NCUA, then we'd recommend the cap be extended to three-years to allow for some flexibility as KCCU would normally manage our WAL at a level comfortably below the cap in order to safely not to exceed this limitation. By extending to three-years it would provide us with the flexibility to manage up to a level of two-to two and a half years to accommodate our fluctuating balances. Another option would be to once again scale the WAL requirements for the credit quality of the asset. A lower risk-weighted asset would be allowed a longer WAL than a higher risk asset. Therefore, if a corporate built a portfolio of high quality assets, the WAL requirement for them would be longer than a corporate that owned a portfolio of lower quality / higher risk investments.

704.8 (f) Cash Flow Mismatch Analysis

This analysis subjects all amortizing investments (regardless of credit quality or underlying collateral) 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 represents a "double whammy" if actual prepayment speeds have already slowed down.

We would recommend eliminating this test and have NCUA rely on the periodic analyses already provided for in Section 704.8(d)(2)(ii). With that authority, if a corporate has chosen to build a portfolio that contained a significant exposure to changes in pre-payment speeds the NCUA could require more stringent testing for that specific corporate. 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, we are doubtful 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 retained earnings portion of the new leverage ratio requirement.

If today's current interest rate environment were to persist, combined with the fact that most corporates are starting with minimal retained earnings, it will be difficult for a corporate to meet the periodic benchmarks for retained earnings. Additionally, the majority of net interest income for corporates is generated from a balance sheet that consists primarily of investments and not loans.

We believe that the model portfolio composition presented on pages 99-101 of the proposed regulation is flawed in many of the assumptions used. Therefore, we were pleased to hear that the NCUA Board had authorized the expense to have an independent third-party model the ability of a corporate credit union to build a portfolio that would meet both the new ALM restrictions and the periodic benchmarks for the generation of retained earnings. We believe that the results of that modeling will indicate that adjustments need to be made to either, or both, the proposed ALM restrictions or to the periodic benchmark dates for the building of retained earnings.

Absent the modeling results and based upon the requirements proposed in the regulation and the current market environment, we would 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 would still represent a significant challenge for any corporate credit union to build that level of retained earnings in those timeframes.

Replenishment of Member Contributed Capital

We can't stress enough that the NCUA Board should allow for some mechanism in the new corporate regulation where KCCU and all corporates can return capital back to existing capital holders if actual losses on the 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. The ACCU has proposed mechanisms that would facilitate the ability to recapture that lost capital. This needs to be included in the final regulation and is the fair and right thing to do.

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

This section contains the statements that "The appropriate minimum capital levels for an individual corporate cannot be determined solely through the application of a rigid mathematical formula" and "The decision is necessarily based, in part, on subjective judgment grounded in agency expertise". This allows for a subjective judgment to be used in determining a corporate's capital status regardless of whether they meet the capital standards for designation at a certain capital level as defined in the regulation. We are concerned that the regulation as written does not identify the methods by which NCUA will ensure consistency in its approach to this subjective measurement and it provides too much power to one individual, in this case, the Office of Corporate Credit Unions (OCCU) Director.

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 such a massive regulation with capital standards and benchmarks and yet give the OCCU Director immense latitude to basically ignore the requirements at anytime for any reason?

We recommend that 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. At the very least, the proposal should be amended to require the concurrence of both the NCUA Board and the state regulator (if the corporate is a state-chartered like KCCU) to change a corporate credit union's capital designation.

704.9(b) Borrowing Limits

This section places a limitation of 30 days on liquidity borrowings and we believe places severe limitations on KCCU's ability to be the main liquidity provider for our members, which was and remains our primary purpose for existence and the reason KCCU was chartered. KCCU has never borrowed funds to invest to generate additional income. We've borrowed to meet the liquidity needs of our members and match term loans to our members with a similar asset. This locked in a favorable spread and eliminated the interest rate risk associated with the loan transaction.

Under the proposed regulation, KCCU would no longer be able to match fund a term loan greater than 30 days which would essentially increase our interest rate risk and most likely limit the amount of term loans we'd want to make. We get the sense that NCUA and many in the industry believe that the FHLB system can step in to meet the longer-term liquidity needs. Many credit unions, especially in Kansas, don't qualify for membership in the FHLB system and therefore don't have access to that lender. Additionally, does NCUA really want to deal with an FHLB lien when they are resolving a troubled credit union issue? Based on our experience, NCUA would normally want to pay-off the FHLB as quickly as possible in that scenario, while the FHLB would have different concerns/priorities.

As NCUA is keenly aware, during the most recent liquidity crisis many creditors reduced available credit or stopped making loans entirely to counterparties. If KCCU is limited to this restriction in the proposed regulation it could actually increase our liquidity risk if another crisis occurs and we are unable to roll 30 day borrowings with our creditors.

This borrowing restriction seems counter to the NCUA goal of ensuring that corporate's are liquidity providers as they were originally conceived to be. It seems odd to us that our lender of last resort for the industry, the Central Liquidity Facility, borrows and lends for a minimum of 90-days but NCUA wants to restrict the system liquidity providers (corporates) to borrowings of 30-days or less. We recommend that this restriction be removed from the regulation as it would limit KCCU and the corporate system from fulfilling a key function of providing liquidity to the credit union industry.

704.14 Board Representation

As a state chartered corporate like KCCU, the composition of the board and the qualifications of individual board members is properly the role of state law and regulation. Preemption of state law would occur with the implementation of this section and we believe it's simply unnecessary. There is no guarantee that qualifications based upon job titles and requiring term limits would improve corporate governance.

We believe that the proposed term limits for directors of six consecutive years is too short of a timeframe 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 especially with the additional limitations on top of the current interlock limitations. We'd recommend the elimination of term limits for board members, but if NCUA decides it's necessary than we'd recommend a term limit of at least nine years.

704.20 Limitations on Indemnification Payments

The proposed regulation imposes what appears to be unlimited personal and professional liability risk for corporate directors and management with respect to decisions that are made in carrying out their official responsibilities. While we understand the intent is to prevent indemnification against regulatory actions, the language is too broad and may cause many qualified and knowledgeable directors from serving due to concerns regarding this potential unlimited personal risk. This proposed change seems to inflict consequences that other financial regulators do not impose on their regulated institutions. We'd recommend to allow corporate credit unions to provide, at their discretion, indemnification coverage for directors and management incurred while performing duties that are not covered by insurance.

704.8 c Penalty for Early Withdrawal

This section eliminates the ability of a corporate to redeem an outstanding certificate at a premium price. We believe that this would eliminate the current attractiveness of a corporate certificate because it would negatively impact the ability of members to convert that asset into cash at a proper price when needed. If a credit union can sell a marketable security at a gain, but not a corporate certificate, then most likely a credit union is going to choose the marketable security as their investment of choice. This is a different decision than in the past, when the corporate certificate was nearly as liquid as the security. As a result, we think this will place KCCU certificates at a competitive disadvantage and reduce our longer term deposits. This will cause us to rely more heavily on short-term and overnight deposits which will make our balance sheet and funding costs more volatile. We recommend that the current rule remain in place for certificate redemptions and if necessary, define a mechanism for how a gain should be paid.

Summary

Credit unions have always worked together to build a system in which all credit unions, regardless of size, can provide member value far beyond the capacity of each individual credit union. KCCU was chartered out of this cooperative spirit in order to provide financial services specifically for the Kansas credit union system. KCCU plays a vital role in the Kansas credit union system and we have worked with our members to reduce the cost of providing services to the over 600,000 consumers that are members of Kansas credit unions. Asset size isn't the objective in which we determine our success, but rather it's more of a reflection of our geographical location. Member support is what determines our value, our success and our future. We do hope that NCUA is sincere in their desire to listen to the comments and allow the 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 their corporate.

Many believe this regulation is designed to force consolidation of the corporate system and the NCUA Chair has stated that "twenty-eight corporates are far too many for a system our size". We respectfully disagree and believe that KCCU, and corporates in general, have a strong market share because they're local, have developed personal relationships with their members and most importantly respond to local needs – which are different in the various parts of our country. Consolidation seems to be contrary to the positions of other regulators and consumer groups that never want to expose tax payers to another bailout of the financial industry. In fact, the recently so-called "Volcker Rule" legislation would block mergers and limit banks to no more than a 10 percent market share. Limiting the size of institutions and spreading risk is the direction other regulators appear to be taking. We believe that the members of each corporate, just like the members of each credit union, should decide the future of their corporate credit union.

We recognize that NCUA has put a lot of thought and consideration into this proposal and that a regulation is required that will never expose our members to the risk of losses that have occurred over the past couple of years. However, regulations cannot presume to eliminate all risk. In order to provide necessary services and add value to members, a financial institution must be afforded some ability to manage risk.

We thank you for the opportunity to comment on the proposed regulation we hope that the NCUA Board will consider our comments as revisions are made to the final regulation.

Sincerely,

Board and Management
Kansas Corporate Credit Union

Larry Eisenhauer,President/CEO
Kansas Corporate Credit Union

Kent Gleason, Executive Vice President
Kansas Corporate Credit Union

Gary Colcher, KCCU Chair
President/Credit Unions United

William Hauber, KCCU Vice Chair
President/Frontier Community Credit Union

Ted Underwood, KCCU Sec/Treasurer
Executive Vice President/Golden Plains CU

Bob Thurman, KCCU Director
President/Credit Union of America

Glen Scott, KCCU Director
President/Kansas Super Chief Credit Union

Wayne Warfel, KCCU Director
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Mark Kolarik, KCCU Director
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