



Credit Union National Association

[cuna.org](http://cuna.org)

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Filed via: [Regcomments@ncua.gov](mailto:Regcomments@ncua.gov)

March 5, 2010

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

Re: NCUA's Proposed Changes to Part 704, Corporate Credit Unions

Dear Ms. Rupp:

On behalf of the Credit Union National Association, I appreciate the opportunity to file comments on the National Credit Union Administration Board's proposed changes to Part 704, Corporate Credit Unions, which were published in the Federal Register on December 9, 2009.

CUNA's comments were developed by its Corporate Credit Union Task Force. Named in December 2008, the Task Force was comprised of Terry West, CEO, VyStar CU, FL, Chair; Bob Allen, CEO, Teachers FCU, NY; Tom Dorety, CEO, Suncoast Schools FCU, FL; Tom Gaines, CEO, TN CU League; Rich Helber, CEO, Tropical Financial CU, FL; Harriet May, CUNA GAC Chair and CEO, GECU, TX; Kris Mecham, CUNA Chairman and CEO, Deseret First CU, UT; Mike Mercer, CUNA Secretary and President, GA CU League; Frank Michael, CEO, Allied CU, Stockton, CA; and Jane Watkins, CEO, Virginia CU, VA. These credit union leaders represent a variety of viewpoints from within the credit union system. They were committed to developing recommendations for the benefit of natural person credit unions of all sizes, and they worked tirelessly to achieve that objective. (The principles which guided the Task Force's work are listed in Appendix A to this letter. A list of those with whom the Task Force met is in Appendix B.) CUNA commends the entire Task Force for its service to the credit union system. By way of background, CUNA is the largest credit union advocacy organization in this country, representing approximately 90% of our nation's 7,900 state and federal credit unions, which serve 93 million members.



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## **CUNA's Prime Goal: Serve the Interests of and Protect Natural Person Credit Unions**

Before addressing the proposal, I want to make some general comments that reflect CUNA's views regarding the future of corporate credit unions and the range of issues presented by their problems. First, I want to emphasize here and reinforce throughout this letter that CUNA's primary objective is to protect the interests of natural person credit unions. CUNA fully recognizes that natural person credit unions must continue to receive essential correspondent services such as settlement, payments, investment options and liquidity resources at reasonable prices.

## **CUNA Supports Corporate CUs but Not the Business Model Many Used**

Additionally, CUNA specifically supports the view that corporate credit unions should be capable of providing or facilitating access to those services now and into the future, particularly for smaller credit unions that have relied heavily on corporate credit unions.

However, support for corporates or any entity providing these services cannot be unconditional. Natural person credit unions are in the process of paying approximately \$9.5 billion, as presently estimated, for losses that resulted from the current business model. This includes an estimated \$6 billion for the Corporate Stabilization, about \$3 billion of lost reserves and undivided earnings of corporates, and upwards of \$400 million in paid-in capital at corporates. Of course, these figures might all change depending on the future disposition of the corporates' legacy assets, but in any event they will be substantial.

As a result, few issues have been as disruptive to the entire credit union system as the corporate credit union investment problems that led to the establishment of NCUA's Corporate Stabilization program (including the share guarantee for corporate credit union deposits and the conservatorships of U.S. Central and Western Corporate Federal Credit Unions on March 20, 2009), the huge capital write downs already taken, and the staggering future costs of these efforts that all federally insured credit unions must bear for years to come.

So while CUNA indeed appreciates the fact that natural person credit unions must be able to obtain key services, and that most corporates have been adept at providing some or all of those services, we cannot for the future condone the business model adopted by a number – not all – of the corporate credit unions to deliver those services. Under that model, corporates offered low-cost payment, settlement and liquidity services financed in part by earnings from large investment portfolios. To achieve sufficient investment yields to subsidize the other services, corporates had to take on excessive amounts of cash-flow mismatching and credit risk, although at the time such steps did not seem unreasonable. Some corporates operated this business model themselves, others engaged in and benefited from it indirectly by virtue of their

membership in U.S. Central. Either way, the results of this model have now been revealed to be totally unacceptable, and a new approach is necessary.

For the sake of the entire credit union system, corporates must make significant, timely changes in their operations to dramatically reduce future risks and prevent future calamities of the nature the credit union system is financing today.

### **A New Model for Corporates or Other Credit Union Financial Services Entities**

Corporate credit unions have been an integral and fundamental component of the credit union system for over forty years, providing essential settlement, payment, liquidity and investment services to natural person credit unions. In recent times, smaller credit unions have become particularly reliant on the range of services corporate credit unions provide them. Yet, because of corporate credit union losses and the ensuing costs heaped on the credit union system, many natural person credit unions throughout the country are expressing their determination not to recapitalize this model, and several groups of credit unions are already developing cooperative models to replace it.

CUNA's Task Force and leadership have responded to credit unions' broad unwillingness to recapitalize the corporates and developed parameters for a new, general business model or models that will ensure much needed services are available, but without requiring significant levels of capital from the credit union system. CUNA's Task Force discussed the need for a new model with representatives from corporate credit unions as well as groups working to develop new approaches.

Some corporates have concluded that they cannot operate under the proposed regulation. They are correct because without radical changes in corporates' business model, their viable operation under the proposed regulation likely is impossible. However, credit unions are demanding a new business model that will require substantially less capital because it is subject to less risk than the old model and will result in improvements in corporates' operational efficiencies. Multiple operating systems of today cannot be supported in the future.

In light of those general concerns, CUNA's Corporate Credit Union Task Force developed the framework for a new model, which should have the following basic characteristics:

- Small balance sheets, comprised mostly of the settlement balances of credit unions.
- Provide payments and settlement services. Ideally, there would be a single national aggregation point for all such entities to concentrate daily settlement.
  - This would protect credit union influence on the financial system and provide opportunities for economies of scale.

- Payments and settlement services would not necessarily be provided by the same entity.
- Meet the short and medium term liquidity needs of credit unions by using, for example, one or more of the following mechanisms:
  - Acting as an agent or clearing house for credit unions to buy Federal Funds from other credit unions or financial institutions.
  - Acting as an agent to facilitate inter-lending among credit unions for longer terms, using peer-to-peer lending systems or other systems.
  - Securing lines of credit or term loans for credit unions based on pools of pledged collateral owned by credit unions.
- Meet investment needs of credit unions by using, for example, one or more of the following mechanisms:
  - Acting as an agent or clearing house for credit unions to sell Federal Funds to other credit unions or financial institutions.
  - Operating or providing access to a money market mutual fund.
  - Operating or providing access to a family of other investment mutual funds.
  - Providing brokerage services.
  - Providing investment advisory or investment management services on a fee basis.
- The entity or entities could provide the full range of other correspondent services on a fee basis.
- All services could be provided through the entity, entities or through subsidiaries or vendors.

In short, the new model envisions institutions with much smaller balance sheets than existing corporates have, that act more as agents than as principals, and with investment risks remaining on natural person credit union balance sheets rather than being concentrated in a number of thinly capitalized wholesale institutions.

## **If Corporate CUs Make Dramatic Changes, They Should Be Able to Provide Services and Access to Services without Undue Regulatory Intervention**

I want to emphasize strongly that in CUNA's view, with sufficient changes that are broadly consistent with the model outlined above, corporates would be able to operate successfully under the proposal and serve natural person credit unions' interests effectively. Further, it is possible, indeed desirable, that one or more of the current corporates could evolve into an entity operating under this model.

CUNA recognizes that the changes required of the corporates will be monumental. Without investments to subsidize the other services of corporates, they will be required to introduce dramatic efficiencies, which will likely require substantial consolidation. It is also likely that some of the services credit unions have secured from corporates in the past will be somewhat more expensive in the future. However, the apparent low cost of those services in the past is now called into question by the over \$9 billion credit unions are paying for the shortcomings of the old model.

Nonetheless, if corporates that operated under that model make bold, necessary, and expeditious changes to their operations to lessen risks and manage their balance sheets properly, then NCUA should allow them to do business under a regulatory framework that promotes safety and soundness, but without undue interference.

## **With the Amendments CUNA Is Recommending, NCUA's Proposal Will Protect the System -- but Legacy Assets Must Be Addressed by NCUA**

With some very important changes addressed beginning on page 9 of this letter, CUNA believes NCUA's proposed changes to the corporate rule would result in an approach that will protect the credit union system from future, unacceptable risks. The corporate business model must be reformed, that is, dramatically improved.

However, as we have urged for many months, no set of reforms can succeed unless NCUA also deals with corporate credit unions' legacy assets, that is, their mortgage-backed and asset-backed securities that have been severely devalued as a result of the turmoil in the overall mortgage market. The primary concern is that the future capital of corporate credit unions be protected from covering future losses related to those assets.

CUNA appreciates the efforts of Chairman Matz to address this issue in a timely manner, as we strongly believe the issues relating to the treatment of corporates' legacy assets must be dealt with at least by the time the final corporate credit union rule is adopted.

We were encouraged by recent meetings CUNA's Task Force had with NCUA officials on this matter, but credit unions continue to express concerns about the lack of details regarding how the assets are being handled by NCUA. Questions such as the following remain:

- Will NCUA establish a “good bank, bad bank” approach in order to manage the assets?
- If that approach is adopted, who would manage the problem assets?
- Will the legacy assets be held and managed to the point of minimum loss, or sold as soon as the unrealized losses fall to the value of the Stabilization Fund?
- Will the approach NCUA is considering regarding the legacy assets require additional borrowings from the U.S. Treasury?

Thus, credit unions seek much more transparency regarding the legacy assets for several reasons. Most important, credit unions are considering now whether they can and should support recapitalizing corporate credit unions into the future. In light of this, it is critical that they have full information to assist with their decision making process. Further, providing more information to credit unions on issues such as this is wholly consistent with the credit union cooperative system, which is based on mutual understanding and cooperation.

We urge NCUA to provide an interim report or Letter to Credit Unions now on its efforts to deal with corporate credit union legacy assets and to have a solution in place in conjunction with the adoption of the final corporate credit union rule.

**How the Credit Union System Will Transition to a New Approach for the Corporates Must be Addressed by NCUA As Part of the Final Rule and by CUNA in a New Working Group**

Another issue that is as important as addressing the corporates’ legacy assets is the matter of how the credit union system will evolve from its reliance on the current corporate credit union model to the full implementation of a new, risk-contained approach that CUNA is advocating. In preparing for that transition period, it is imperative key players in the system not assume a passive role and simply let developments unfold. Rather, they must step up and assume leadership responsibilities to ensure disruptions in services to natural person credit unions are minimized.

As one of the key components of the credit union system, NCUA must be among the organizations that help ensure the transition is effective and will lead to the right result – continued access to services for natural person credit unions from entities that can manage their risks appropriately. Because a significant amount of consolidation will likely be part of the evolution of the corporate system, it will be imperative for NCUA to adopt policies that at least facilitate, if not encourage, mergers among corporates with a view to establishing healthy, viable and efficient organizations. NCUA has a practice of encouraging some troubled natural person credit unions to seek merger partners with a view to preserving the continuation of member service and minimizing losses to the share insurance fund. A similar approach should be considered for troubled corporate

credit unions unable to revise their business model in a reasonable amount of time, in order to ensure continued service to natural person credit unions and to contain losses.

While the transition period is not fully discussed in the proposal, some important elements are addressed. The Supplementary Information to the proposal provides, “NCUA has the authority in appropriate cases and within the context of a carefully crafted investment action plan, to permit individual corporates to operate outside” certain limits of the proposal.

Also, the proposal has provided a phase-in of key components of the regulation, such as the capital requirements.

Nonetheless, the proposal does not sufficiently describe how a transition period could work. In light of this, substantive issues associated with the transition must be addressed in the final rule. This should include NCUA’s role in helping to ensure the transition is orderly and successful. For example, NCUA should consider changes to the characteristics of contributed capital accounts that would facilitate a transition to a new model. Most important, CUNA supports NCUA’s use of its authority to extend elements of its share guarantee program until the corporates’ legacy assets have been satisfactorily resolved (authority the agency used very recently to extend the guarantee through June 30, 2012).

CUNA is not suggesting that NCUA must come up with all the answers regarding the transition period by itself. In that connection, CUNA is forming a new Working Group on Next Steps to help address the transition period and implementation of the broad model CUNA is recommending. The working group will be appointed shortly and will be reaching out to stakeholders as it considers ways to help ensure natural person credit unions have ample access to needed correspondent services.

There is no question that there will be transitional difficulties in moving from the current system to a new model. It is not clear if some of the existing corporates will evolve to operate according to a new model, or if completely new entities will be formed. During the transition, it is imperative that NCUA, CUNA, Leagues, corporates, and natural person credit unions work together to minimize disruptions, such as loss of service or loss of capital. The continued availability of reliable and affordable payments and settlement services, liquidity and investment options, particularly to smaller credit unions, is vital.

## **NCUA Should Not Impose Investment Limits on Natural Person Credit Union Investments Based on Investment Provisions in the Corporate Rule**

As discussed, the model developed by CUNA's Task Force envisions that corporate credit union investment activities would be severely curtailed. As a result, investments of natural person credit unions would be held exclusively on their balance sheets, rather than also being held on the balance sheets of corporates as they are today. Those credit unions that have in the past relied on corporates exclusively for their investments will need to maintain or develop the tools and resources to manage those risks as opposed to relying on corporates to handle them.

Even though the risks of their investment decisions would reside with natural person credit unions or other providers, there is no need for further regulation under 12 CFR 703 to address those risks. The scope of permissible investment activity for federal natural person credit unions is already far more limited than the scope of permissible investment authority for corporates under Part 704. In any case, under the current 703 and other provisions, NCUA already has sufficient authority to regulate investment activity at the natural person credit union level.

Thus, CUNA opposes any revisions to NCUA regulations concerning credit union investments based on the proposed changes to the corporate rules in Part 704 as wholly unnecessary. Further, many of the investment restrictions that might be appropriate for a corporate credit union are wholly inappropriate for a natural person credit union. This is because of the greater significance of member loans on natural person credit union balance sheets, their higher capital requirements, and the greater restrictions on their investment options.

However, while natural person credit unions do not need further investment regulations, they will continue to need sound investment advice, options, due diligence expertise and other resources. Under the model the Task Force developed, natural person credit unions would have access to such investment services from corporates or other entities operating under that model. It would also be useful for NCUA to consider providing a list of pre-approved investment vehicles that could be updated on NCUA's website to assist natural person credit unions in making their investment decisions. Smaller credit unions should be able to hire third-party investment managers to manage their investments completely, subject to the credit union's board approved investment policy.

In any event, CUNA and the leagues will continue providing affordable education and training to credit unions on investments and due diligence, working closely with NCUA and NASCUS.

## **NCUA's Proposal and Recommendations for Improvements**

Although NCUA's proposed regulation does not explicitly adopt or promote any specific business model for the corporates, the above approach would be very consistent with the proposed regulation. This is because the capital requirements and asset liability management (ALM) components of the regulation militate against large balance sheets at corporate credit unions.

In recognition of the need to address inadequacies in the current corporate credit union model, after long and careful consideration, CUNA has concluded that the main elements of NCUA's proposed regulation would help achieve the desired result of minimizing risks to natural person credit unions, and it is consistent with credit unions' need to avoid significant future losses. Further, CUNA agrees with NCUA's overall objectives and the approach of the proposed corporate credit union regulation.

Nonetheless, the proposed regulation overreaches in certain key areas, and CUNA has concluded that substantial changes are necessary to ensure future entities will be able to operate in the best interests of natural person credit unions. The following are substantive areas CUNA urges the NCUA Board to correct and address in the final rule.

### **I. Capital and Prompt Corrective Action**

The proposal delineates required capital levels, which appear to be reasonable, and CUNA supports the capital system NCUA is proposing under which there are specific leverage ratio requirements as well as risk-based requirements.

However, the agency would reserve broad authority for itself in several areas, such as requiring additional capital of individual corporate credit unions for "good cause" as well as redesigning the risk-weighting of assets, as it deems appropriate under the provisions of the proposal. We do not support this approach to regulation.

One of the most important reasons for a regulation is to provide certainty as to its requirements to stakeholders. This objective is undermined by such broad and potentially arbitrary authority, which would allow the agency to impose much more stringent requirements than those spelled out in the regulation. We believe that the combination of new prompt corrective action and much more stringent capital requirements that are provided in the proposal are sufficient authority for NCUA to address capital and other supervisory issues without the need to assume such sweeping new authority. Further, without more discussion of the circumstances of how the authority would be used or its outer boundaries, we question whether this approach is consistent with the Federal Credit Union Act, given its potential for arbitrary case-by-case application.

Also, as discussed above regarding the transition period from the current corporate business model, corporate credit unions that are making good faith efforts to change

their functions and operations should be given some leeway in meeting certain capital standards, such as specific retained earnings targets. No one knows how long the transition period may take, although for the sake of natural person credit unions, it needs to be sooner than later. Nonetheless, the regulation should provide some flexibility in situations where corporates are making important changes and moving forward with a new business model particularly during a transition period.

CUNA's comments to NCUA on the Advance Notice of Proposed Rulemaking supported a new prompt corrective action (PCA) system for the corporates. While the Federal Credit Union Act does not expressly provide PCA for the corporates, given their recent history and potential future role in the credit union system, we believe PCA for corporate credit unions is necessary and appropriate. However, since PCA for corporate credit unions is not directly authorized in the Act, we are very concerned about the extent of the authority NCUA has reserved for itself to downgrade a corporate credit union's capital category and impose PCA sanctions for reasons other than inadequate capital. CUNA supports PCA for corporates but only to the extent it is reasonable, fair, and consistent with the Federal Credit Union Act. We urge NCUA to review this section and revise provisions that may be arbitrarily applied.

## **II. Corporate Governance Issues**

In general, the corporate governance requirements are too prescriptive and some of them are unnecessary. For example, we do not support the prohibition on indemnification of officials, and the requirements for disclosures of executive compensation are too cumbersome. While CUNA agrees that executive compensation information should be available for review by members, we recommend that such disclosures follow standard formatting and guidelines used by other entities for the disclosure of similar information.

Also, as we stated in our comments on the ANPR, there could be real benefits to corporate entities having "outside" directors who have specific expertise in certain areas. In that connection, we recommend that the final rule expressly provide that up to 20% of the directors of a corporate entity could be drawn from outside the credit union system, consistent with the corporate entity's bylaws and other applicable requirements.

## **III. Derivatives**

Under the proposal, NCUA would significantly limit the authority of a corporate entity to use derivatives. While such activities may not be appropriate for all corporate entities, if a corporate has the appropriate expertise, it should be able to offer derivatives to help natural person credit unions manage their risks.

#### **IV. Credit Union Service Organizations**

The proposal would replace the current list of prohibited activities for corporate credit unions service organizations (CUSOs) with a section on permissible activities. A corporate CUSO would be required to limit its activities to only those included in the section, which will be listed on NCUA's website. CUNA does not support this approach.

Corporate CUSOs can be very useful in the delivery of key services to natural person credit unions and could help facilitate the emergence of new business models, but NCUA's proposal would stymie their ability to enter into new activities.

The proposed approach is too restrictive and may result in reluctance on the part of corporate CUSOs to consider new products that are not pre-approved by NCUA, at the very time such entities should be encouraged to meet the needs of natural person credit unions for key services. We urge NCUA not to assume the role of having to approve activities for CUSOs but to continue the current process of delineating those activities that are prohibited. This approach would facilitate the development of corporate CUSO services while ensuring inappropriate activities are avoided.

#### **V. Third-Party Review**

NCUA is engaging a third party to review its analysis and modeling under the proposal. NCUA should direct the third party to develop assumptions independently, particularly in the areas of asset liability management and testing, and provide a full accounting to credit unions of the third party's scope of review and findings, before the new regulation is adopted.

#### **Conclusion**

To summarize CUNA's views, because of the costs natural person credit unions must bear now and into the future as a result of the risk-taking by corporates that was not offset by sufficient capital, few issues are more important to the credit union system than ensuring future risks associated with delivery of settlement, payment liquidity, and investment services will be well-managed and thus, minimized.

In light of the magnitude of these issues, CUNA, based on the guidance from its Corporate Credit Union Task Force, is urging that a new business model for the delivery of key services to natural person credit unions be developed, with the characteristics broadly outlined in this letter. Operating under that model, we believe existing or new corporate entities could succeed under NCUA's basic proposed regulatory framework, and we support that framework, although we are urging significant changes to the final rule.

We also urge NCUA to address the issue of legacy assets by the time the final rule is adopted and provide an interim report to the credit union system in the meantime. Also, we call on NCUA to be proactive regarding the transition period to a new model and

address the transition in the final rule. In addition, we urge NCUA to make the report of the report of the third party review available to the credit union system. Further, as identified by CUNA's Task Force, there appears to be a widespread lack of knowledge and information about future risks to natural person credit unions if the current corporate model is not changed. CUNA believes it is essential that NCUA, CUNA, the Leagues, and credit unions work together to provide more information and education to credit union officials and management regarding the risks they are facing and how such risks could be minimized.

In conclusion, CUNA's foremost goal in addressing issues relating to corporate credit unions has been to protect the interests of natural person credit unions, including their ability to obtain essential correspondent services. The proposed general model will accomplish that goal, and we believe corporate credit unions that adopt this model, or something very similar to it, can continue their role in providing those services directly or in concert with others. Our Working Group on Next Steps will be addressing how these recommendations can be implemented.

Corporate credit unions can succeed, but not under their current model. Sweeping reforms of this magnitude cannot happen without the support of many and in this case, it will be essential for corporate credit unions and the natural person credit unions that they serve to agree to such changes as quickly as reasonably possible. Nothing less than the future of the credit union system is at stake.

Sincerely,

A handwritten signature in cursive script that reads "Daniel A. Mica". The signature is written in black ink and is positioned above the typed name and title.

Daniel A. Mica  
President and CEO

## **Appendix A to CUNA's Comment Letter on NCUA's Corporate Credit Union Proposal**

### **Mission of the CUNA Corporate Credit Union Task Force:**

The mission of the CUNA Corporate Credit Union Task Force, in light of the current problems and issues in the corporate credit union system, has been to consider how natural person credit unions can continue to have access to key services such as settlement and payment services as well as liquidity and investment options, and to develop recommendations to the CUNA Governmental Affairs Committee and CUNA Board regarding CUNA's comment letter to the National Credit Union Administration on its proposed corporate credit union regulation.

### **CUNA's Corporate Credit Union Task Force Guiding Principles:**

- The interests of natural person credit unions (credit unions) are above all others.
- Credit unions have made it clear that they are unwilling to invest significant amounts of capital in corporate credit unions (corporates) that operate under the current corporate business model.
- Credit unions require access to settlement, payments, liquidity, investments and other correspondent services. It is preferable that the source of these services be entities owned and controlled by credit unions. It is not necessary that all of these services be provided by a single entity for each credit union.
- Credit unions will not accept entities to meet their financial services needs that impose significant risks to them, either in the form of exposure of the capital invested by credit unions in these entities, or through the share insurance fund. Credit unions want NCUA to help prevent another systemic crisis such as the one just experienced.
- Whatever entities emerge to serve the financial services needs of credit unions, they will require some level of capital from credit unions. The entities that succeed will be those that require less capital by assuming less risk, and that offer key services that are effective and of low cost to credit unions.

**Appendix B to CUNA's Comment Letter on  
NCUA's Corporate Credit Union Proposal**

**Individuals and Organizations with Whom Representatives  
of the CUNA Task Force Met in The Course of Its Work**

- CUNA's Small Credit Union Committee
- CUNA Directors representing smaller credit unions (up to 20,000 members)
- Individual Corporate Credit Union Chief Executive Officers
- The Association of Corporate Credit Unions
- Callahan & Associates President Chip Filson
- CUNA Board Member and Community America Credit Union Chief Executive Officer Dennis Pierce
- Open Financial Solutions Chief Executive Officer Rae Miles
- National Credit Union Administration Board Members and staff who drafted the proposal
- CUNA Governmental Affairs Committee
- CUNA Board of Directors