Tricorp Federal Credit Union

March 4, 2010

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

RE: Proposed Revisions to Rule 704

Dear Ms. Rupp:

On behalf of the Board of Directors, Tricorp Federal Credit Union appreciates the opportunity to comment on NCUA's proposed changes to Part 704 regarding corporate credit unions. NCUA issued this Proposed Rule soliciting comments on several issues including capital, permissible investments, management of credit risk and liquidity and corporate governance.

In commenting on the regulation we believe that it is important to first look at what caused the credit losses in the corporate system and what did not.

The Problem: Competition and Expanded Investment Powers vs. 3-Tier System and Efficiency

The current crisis in the Corporate Credit Union System was created by introducing an environment of competition and expanded investment powers into an industry where the business model was founded on cooperative principles and flourished in a cooperative model of aggregation (i.e. pooling the buying power of the industry). The flawed premise for these regulatory changes seemed to be centered on the notions that the system was not efficient enough, that there were too many corporate credit unions, and that consolidation of the industry was necessary. It is essentially outlined in the preamble of the proposed regulation that NCUA created this competitive environment through expanded fields of membership (some 15+ years ago) to specifically introduce competition in order to allow the bigger/stronger/more sophisticated and efficient to survive while weeding out the weak. Expanded investment powers were also granted to those with "infrastructures capable of managing risk" in what appeared to be an effort to further boost the goal of consolidation and efficiency.

What happened instead was that several large to mega-large Corporate Credit Unions began to emerge with the goal of being the "winners or survivors" of this new environment and they all departed in varying degrees from the 3 tier system to differentiate themselves and to gain market share. Ironically, in executing their strategy **they actually diluted rather than improved efficiencies** in the system by fragmenting the model of cooperation and aggregation. Risk profiles were increased significantly to compensate for the diluted efficiencies, subsidize the marketing campaigns against competitor Corporate Credit Unions, and subsidize marginally successful strategic initiatives of recreating the aggregation (including key payment systems) that already existed. Ultimately the environment became toxic and led directly to toxic assets, but even without a global financial crisis to expose the flaws so quickly the fate was inevitable. When in the latter part of this 15+ year journey the largest Corporate Credit Union was aspiring to become a direct competitor with US Central while at the same time having a protected US Central Board seat, the toxic environment and demise should have been evident to everyone.

While the academic thought exercise of how consolidation should lead to greater economies of scale and efficiency is a tantalizing concept on paper, economies of scale and efficiency were never problems and certainly did not need fixing. To be clear, this ill-conceived and ill-fated attempt at improving the efficiency of the Corporate System actually diluted efficiency and led directly to the current crisis.

The Solution: Proposed Regulation vs. Supervisory Oversight and 3-Tier System

While legislating and/or regulating certain business activities are possible, the power to consider all behaviors of the regulated or control outcomes with any degree of certainty is not something that can be accomplished by regulation. There is little doubt that the regulatory revisions and re-writes over the past 15+ years had the best intentions of the entire credit union system in mind, but the tantalizing thought exercise on how to encourage economies of scale and efficiency were severely deficient in considering the overused terminology of our day: “Unintended Consequences”. We agree that the regulatory role needs to be adjusted to allow the industry to thrive and flourish without excessive risk exposure. However, we strongly believe there is already sufficient authority in the current regulation to ensure the safety and soundness practices of Corporate Credit Unions and there are more than sufficient supervisory examination resources and remedies already within the agency’s supervisory role to correct behaviors that may lead to the so-called “unintended consequences”. The proposed regulation will have 2 key affects on the landscape of the credit union industry:

1. Increased Cost of Doing Business/Viability: The regulation will increase the cost of doing business with a Corporate Credit Union or outright eliminate the Corporate Credit Union viability in the marketplace.
2. Consolidation: For reasons not fully explained, the regulation again significantly encourages consolidation into a few large mega-Corporate Credit Unions. In fact the preamble anticipates some 4 mergers per year. It is curious at a time when the larger financial services industry is seeking ways to dismantle or dilute this concentration of financial power that the NCUA’s proposed regulation encourages further consolidation in an oligopolistic model. There were Corporate Credit Unions building (what turned out to be) risky portfolios to enhance yield and subsidize the aggregation they had abandoned and attempted to recreate, subsidize marketing campaigns against former collaborators, and subsidize pricing of key products and services to gain market share. The current proposed regulation and NCUA public comments indicate that this oligopoly model is roughly the result they want.

In fact, the 3-Tier system with a US Central thrived for nearly 25 years with no major or minor disruptions. Only when CapCorp broke away and abandoned the aggregation already built into the system was there a disruption. CapCorp basically took on more interest rate risk to subsidize and add value for breaking away from the aggregation already in the system. The regulatory changes that enabled competition encouraged the same behavior as CapCorp only this time credit risk was the culprit. To be clear Tricorp believes there is no need for a new regulation that attempts to accomplish what can only be accomplished by supervision and examination. Additionally, the 3-Tier model that flourished for nearly 2 ½ decades without incident is the solution to the recent problems in the industry and never should have been abandoned in the first place.

Having stated this, Tricorp is under no delusions that our recommendation will be adopted so we will highlight our specific concerns over the proposed regulation. As the proposed regulation is currently written, any corporate including Tricorp that has stayed true to its core mission and did not engage in risky investment strategies will find it very difficult, if not impossible, to comply with the additional tests in the regulation for credit spread widening. Combine the credit spread widening test with the weighted average life limitation and the obligor limits, this proposed regulation is too restrictive and needs to be re-worked so that Tricorp and the corporate system can continue to provide the valuable products and services that our members utilize every day.

<u>Corporate Capital/Core Capital/PCA</u>

Tricorp favors moving to a capital ratio that consists of risk-based core capital. However the corporate system has lost the capital that has been built up over the past 30 years and adequate time should be given so that credit unions that have already paid enough in lost MCA and PIC do not have to pay much higher fees while earning significantly less on their corporate deposits.

The additional tests in the proposed regulation including the credit spread widening test and the 2 year weighted average life limitation will severely restrict our ability to meet the retained earnings requirements. The regulation includes PCA violations for these additional tests. This regulation also strongly encourages the shrinking of corporate balance sheets at a time when credit union liquidity is at an all time high. In doing so it will further erode the ability of corporates to earn income and meet the retained earnings requirement.

Corporates will need to raise PCC in order to meet the 4% leverage ratio beginning 1 year after the Final Rule is adopted. How much will need to be raised will depend on the size of our balance sheet and the level of retained earnings achieved at that point. Given all of the other restrictions in the regulation in combination with the Asset Liability Management restrictions, it may be that a corporate will find itself in PCA even though it is making good progress to adapt to the new regulations while managing a conservative balance sheet.

We recommend that PCA compliance and regulatory remedies be eliminated for the NEV type testing. PCA is a widely used regulatory tool for all types of financial institutions but it without precedent that PCA be applied beyond the routine capital measures of Tier 1 Leverage, Tier 1 Risk-Based Capital, and total Risk Based Capital.

Additional Capital Considerations

Chairman Matz indicated in a recent speech at the GAC conference that PCA rules would be relaxed for natural person credit unions if any resulting violations were simply from growth in deposits that were incidental to deposit growth in the marketplace. This presumably means the NCUA recognizes that the current economic downturn has biased the public toward demanding more savings and deposit products (asset growth that would dilute capital ratios) and away from loans. Given these extraordinary times Chairman Matz indicates NCUA would utilize a common sense approach to enforcement rather than simply following the letter of the law in a bureaucratic fashion. Tricorp applauds this pragmatic approach to regulation but would request the same pragmatism for Corporate Credit Unions especially during the difficult rebuilding years for corporate credit unions and the extraordinary times for deposit growth compared to loan growth. Retail credit unions have much more stable balance sheets and will be granted forbearance, so it would follow that corporate credit unions should also be afforded the same. This is especially the case given:

1. Liquidity Function for System - the nature of the corporate credit union balance sheet functions with a high degree of sensitivity to the public's demand for deposits versus loans. In economic downturns the public's bias is typically toward savings and away from loans whereas in periods of economic growth the public is typically biased toward loans and away from savings. As individual deposit growth accumulates across the credit union system and outpaces the system's loan growth, corporate credit unions typically act as the buffer and deposits grow exponentially compared to the natural person credit unions. This very significant function can cause extremely large fluctuations in asset size and capital ratios as the economy moves from one cycle to the next. It is important that this function be preserved and qualitative considerations for the safety and soundness of capital adequacy be weighted more heavily than an arbitrary ratio.
2. Extraordinary Economic Times – the extraordinary times have already put strain on all participants in the financial services industry, including credit unions. The Chairman's recognition and common sense in approaching natural person credit unions on this matter is admirable, pledging to focus on the qualitative considerations of safety and soundness for capital adequacy rather than an arbitrary ratio. As this cycle continues with no real end in sight, corporate credit unions deserve parity especially given our "Liquidity Function" for the entire system.
3. Forbearance for Natural Person Credit Unions – the forbearance signaled by the Chairman to Natural Person Credit Unions will exacerbate the deposit growth and resulting capital ratios for corporate credit unions. Additionally, this is all happening at a time when the system is already significantly weakened and is entering rebuilding years. The qualitative considerations for the safety and soundness of capital adequacy should be weighted more heavily than an arbitrary ratio.

For the reasons stated above, Tricorp recommends forbearance in PCA enforcement for deposit growth that is incidental to the broader marketplace and the economy and during these difficult rebuilding years.

Asset Liability Management

As mentioned above, the combination of a 300 basis point spread widening test for all investments, a 50% slowdown test in prepayment speeds and a two year weighted average life is overly restrictive.

If these proposals are left unchanged, it will have a major impact on Tricorp's ability to manage its balance sheet with floating rate agency investments. Floating rate investments have been an integral part of Tricorp's investment strategy that has allowed us to manage interest rate risk with no credit risk that allows us to pay a reasonable rate of return to our members. The ability to generate a reasonable interest rate margin to build retained earnings will become dependent upon a lower cost of funds for Tricorp members. This may further exacerbate our ability to build retained earnings if members move the funds to other depositories.

Tricorp has modeled its current balance sheet with the new proposed regulations. Tricorp has always maintained a very conservative balance sheet and continues to do so. In the current regulation Tricorp has easily met the NEV requirements and did so all through the crisis. Even today after having lost $38 million of capital we are still able to meet the limit for the amount of percent change allowed in a 300 basis point shock scenario. Taking the same balance sheet we find that the percent change in our NEV testing would put us in a PCA situation even though we have a very short, very conservative balance sheet.

We recommend that the Proposed Rule be amended to a more realistic 100 basis point credit spread widening test and a 35% NEV volatility tolerance limit. The tests also include Agency investments which would have no concentration limits in the proposed rule. There is a significant difference between Agency issued debt and other securities. These securities trade in a very large and liquid market and therefore we recommend not including them in "credit spread widening tests" since there are no credit issues.

Single Obligor Concentration Limit

The propose rule that limits the single obligor concentration limit to the greater of 25% of capital or $5 million is too restrictive. While there are exemptions for U.S. Government of GSE issued debt, Tricorp may need to seek other obligors to either invest in or use for settlement purposes. Tricorp would need an untold number of obligors because of the very small limit in the proposed rule. While we can currently utilize the Federal Reserve Bank for the purposes mentioned above, that will work as long as the Fed continues to pay interest on excess balances. If that were to change then we would need to utilize a large money center bank and the obligor limit would make that virtually impossible to cover settlement balances.

Overnight investing was not a problem in the current crisis and we recommend that the obligor limit have an exception carve out for overnight type investments in order to not dismantle the aggregation.

Indemnification Payments

It will be difficult to maintain volunteers and management if they are uncertain as to whether or not there is proper indemnification coverage for performing duties that are well within the duties and responsibilities of each. The determination of whether or not those duties and responsibilities were being performed in "good faith" could be left to a subjective judgment.

We believe that Tricorp should be allowed to continue to provide proper and commercially reasonable indemnification coverage as it deems necessary for directors and management while performing duties that are conducted in good faith and in accordance with all applicable laws and regulations.

Corporate Governance

Tricorp agrees that there should be an appropriate level of experience and expertise for an individual to be a director of a corporate credit union. Tricorp has already changed its bylaws in this regard by requiring that all board members be a member of a member credit union's senior management as defined in the propose rule. However we are opposed to the term limits in the proposed rule.

Many current and former board members state that it takes at least one term to truly understand the inner workings of a corporate credit union. Term limits can have the unintended consequence of having inexperienced board members unless the limit spans for several terms. While corporates do differ in many significant ways from natural person credit unions, they are still member owned not-for-profit financial cooperatives that are democratically owned and operated by and for the benefit of the members. This is basic principle of credit unions and the members of Tricorp should be allowed to determine who serves on its board.

Additionally we will see a significant turnover in the Board of Tricorp in the next 3 years at a time when we will need the experience and knowledge of seasoned directors more than ever.

Prohibition on Replenishing Capital

NCUA should not require permanent depletion of capital based on estimated OTTI model predictions and should allow for a mechanism to exist where corporates would be able to replenish capital back to existing capital holders if actual losses are less than projected. NCUA has stated that current losses are tracking slightly above projections but these losses are projected well into the future and there could be a change in the value of those securities.

In separate communications and discussions with the NCUA, the ACCU developed a model and mechanism that would facilitate the ability of member credit unions to recapture depleted capital by having corporates segregate and measure the performance of previously impaired legacy assets from all other assets. Future recoveries in value should be returned to the NCUSIF first but any possible further recoveries could be available to return to the original member contributed capital holders in the form of a "paid in kind" PIC dividend and once a corporate met all regulatory hurdles, the Corporate's board could determine that any portion of the paid in kind PIC balance could be redeemed in cash. The corporate credit union would thus possess the right, but not the obligation, to pay recovery dividends.

Prohibition Against Redeeming Certificates at a Premium

The Proposed Regulation eliminates the ability of corporates to redeem, by policy, outstanding certificates at market rates even if those rates generate a premium dollar price. This will place Tricorp and all corporates at a tremendous disadvantage essentially nullifying any institutional funding market opportunity for term certificates. Tricorp has become an investment alternative for its members by offering a term product the mimics the market place thereby giving credit unions the opportunity to earn a market rate of return while also having the ability to redeem those certificates if their liquidity tightens. Tricorp members have only redeemed certificates for liquidity purposes and have not engaged in the types of redemption practices that would be considered "trading". Tricorp has simply either charged for a principle loss or passed on a gain based on a market price.

NCUA has repeatedly stated that credit unions need to support the credit union system with liquidity so as to not force the sale of legacy assets in a distressed market. Credit unions have responded very admirably and the purchase of corporate certificates continues to be an important piece of system liquidity. This change will adversely impact system liquidity and will put stress on the liquidity position of U.S. Central and other corporates that have those legacy assets.

The proposed rule does contemplate and strongly steer corporates to smaller balance sheets. The longer term prospects for corporates offering term products on their balance sheets appears to be something that will be transitioned off of our balance sheets over time. However we are concerned about the time frame for a transition for credit unions to other alternatives and we feel that until there is a system solution for assisting credit unions to utilize other alternatives, credit unions should be able to redeem certificates from their corporate at a market price in order to properly manage their liquidity. Otherwise we may prematurely impact liquidity for the entire system and possibly raise costs for the NCUSIF.

Elimination of the provision in the regulation for a wholesale corporate

We understand the damage that has been done to the U.S. Central name but we still maintain that the structure of the corporate system or the number of corporates did not cause the current problem. It is an investment problem that was caused by an overreliance on one particular asset class that even the brightest of investment experts including the rating agencies did not anticipate. The appetite for risk taking brought on by a desire by NCUA to reduce the number of corporates through national fields of membership and expanded investment authority are big contributors to the current situation as well. Still we recognize that U.S. Central's name is probably damaged beyond repair but we have a number of concerns as to how the NCUA plans to unwind U.S. Central.

A. When (and where) does NCUA expect all of the funds currently at US Central to be moved out given that they have steadfastly asked for credit unions to keep deposits in the system?
B. What impact will this have on the national originator payments that currently settle at USC and how will that be transitioned to another solution?
C. What alternative's are available for Tricorp that are acceptable to NCUA to manage millions of dollars in overnight deposits
D. How will NCUA wind down the term portfolio at US Central?
E. Tricorp has a $300 million line of credit at US Central – how will that be replaced?
F. NCUA should preserve the core functions of US Central. Otherwise a great deal of expense will be incurred to recreate the essential services that are currently provided. This will increase the cost of services from Tricorp and may lead to the elimination of a term portfolio on Tricorp's balance sheet

We recommend that the very valuable functions currently provided by a wholesale corporate – overnight deposits, settlement and lines of credit be preserved in some form so that there is no serious disruption to the payment system for credit unions. This can be accomplished through a scaled back version of a wholesale corporate and/or through a CUSO.

On behalf of the Board of Directors and all of us at Tricorp, I want to thank you for the opportunity to comment on the Proposed Rule. We look forward to strengthening and improving the corporate credit union system so that we are able to appropriately manage through tough economic circumstances in the future.

Sincerely

Stephen A Roy

Stephen A. Roy
President/CEO