CenCorp®

CENTRAL CORPORATE CREDIT UNION

March 5, 2010

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

Re: Response to Proposed Rule for Corporate Credit Unions (12 CFR Part 704)

Dear Ms. Rupp:

Central Corporate Credit Union (CenCorp) thanks the NCUA Board for the opportunity to comment on the proposed changes to the regulations for Corporate Credit Unions (Corporates). As background, CenCorp is a $2.9 billion institution that serves approximately 330 credit union members based primarily in Michigan.

CenCorp believes that most of the additional investment concentration and/or sectors limitations proposed address the credit risk issues that resulted in the large losses at Corporates in recent years. The proposed rule goes further to establish other regulations that impact Corporate operations in other areas. The proposed restrictions on Asset/Liability Management (ALM) and earning retention requirements are of particular concern. In summary, CenCorp believes that our projected net income from operations (approximately $4 million annually) would be eliminated if it were to operate under the guidelines as proposed. This would reduce the value generated for members.

The proposed rule covers a wide range of Corporate activities. It doesn't specifically cover the longer-term funding needs of US Central or the existing interrelationship between Corporate operations and US Central during the transition to the new regulatory environment. CenCorp's comments on the proposed rule are being made without this information.

We initially provide some background information on member use of products as an indication of CenCorp's role today. CenCorp's comments on the proposed rule are presented thereafter. Certain sections of the proposed rule have been grouped together for discussion purposes. The significant areas of concern for CenCorp (ALM and capital) are presented first. Comments of lesser concern are presented thereafter. References to the sections that a comment relates to are indicated throughout this response.

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Member Use of CenCorp Products

CenCorp's primary products are widely used by members. Members have consistently kept approximately 85% of their overnight funds at CenCorp (most of the remainder is at the Federal Reserve). CenCorp is also members' most used source for overnight borrowing. A summary of CenCorp's Michigan market share of various correspondent services is presented below. The market share numbers for members with over $10 million in assets are shown separately to reflect the fact that some smaller members don't have a need for many of the products (e.g., they don't offer share draft accounts to members).

	All Members	Members Over $10 Million
Item Processing	69%	76%
Transit Processing	67%	79%
Wire Transfers	73%	86%
Cash	41%	48%
ACH Receipt	33%	33%
ACH Origination	25%	31%
Business Services	31%	39%

Through their collective strength and support of CenCorp, members have traditionally received favorable product offerings/pricing and built an organization that is dedicated to serving their needs in the future. Members have always had the prerogative to use CenCorp or an alternative provider for any service. CenCorp's market share in the principal products that it offers is an implicit indication that members have found overall value in the products that CenCorp provides.

CENCORP COMMENTS ON THE PROPOSED RULE

Asset/Liability Management (Section 704.8)

Interest rate risk limitations for financial institutions typically consists of a maximum percentage change in the institution's Net Economic Value (NEV) as the result of a 300 basis point interest rate shock. The NCUA uses a similar methodology as a base. It then proposes the addition of a "credit spread widening" provision and imposing a two-year weighted average life limitation on the Corporate's investment portfolio. The combination of traditional shock test with the other restrictions nearly eliminates a Corporate's ability to invest in floating rate investments.

As background, the rates paid on floating-rate assets typically purchased by Corporates change based on a referenced index (usually the one-month Libor rate). The rate paid is a margin (spread) over the particular index. The margin demanded by the marketplace can widen or narrow over time (not for the security after it has been issued). This new provision requires that a change in the market value of a floating-rate investment resulting from a credit spread widening of 300 basis points be included in the NEV calculation (i.e., in addition to the interest rate risk limitation).

In the *standard* NEV shock test, floating-rate assets have minimal interest rate risk because of their frequent (generally monthly) rate resets. The implementation of the spread widening shock in the proposed rule would substantially eliminate the interest rate risk limiting benefit of investing in floating-rate investments and force Corporates to shift floating-rate investments into overnight investments. CenCorp currently expects to own an average of $800 million in floating-rate assets in 2010. These investments are expected to earn 33 basis points more than overnight investments. The reduction in annual net interest income from a shift away from floating-rate to overnight investments equates to $2.6 million. This is just over *half* of CenCorp's projected income in 2010.

In the preamble to the proposed rule (pages 99 – 101), the NCUA sets forth an "example" Corporate that could theoretically earn 21 basis points annually and meet the earnings retention requirements in the regulation. The example contains some unrealistic assumptions on the availability of securities, average rates, and weighted average lives. The margin assumed on the student loan security in particular is much larger than what CenCorp believes is available in the market. In summary, a Corporate could not actually attain the earnings under the scenario presented by the NCUA.

CenCorp estimates that its net income would decline by approximately $4 million in total if it were to operate under the proposed rule. The bulk of this difference is due to the decline in floating-rate investments noted above. The remainder is due to investment changes and reduction in CenCorp's asset size due to other provisions in the proposed rule. These are described in greater detail on Schedule 1. CenCorp would operate near breakeven unless it significantly reduced returns to members or made other changes.

Investments are subject to the inherent risk of credit spread changes in the marketplace like any other interest-earning asset on a financial institution's balance sheet. Barring a forced liquidation, this financial institution manages this risk in the normal course of business. Instead of adding this credit widening concern to interest rate measurement, CenCorp recommends that it be excluded from the interest rate shock testing. Agency securities have historically not been as susceptible to credit spread widening. Agency spreads actually decreased slightly during the investment market upheaval in late 2008. If a Corporate can obtain adequate liquidity from other sources, then the credit spread widening on a portion of its investments (that wouldn't need to be liquidated) would be manageable. CenCorp suggests that a limit on non-agency securities as a multiple of capital would be a better approach if credit spread widening is considered significant.

Floating-rate assets typically have original weighted average lives in excess of two years. This would restrict the purchase of these types of securities, including agency-backed, and lead to the purchase of other securities with lesser yields and/or more credit risk. It will also become problematic in the seasonally low liquidity period in late summer when Corporates typically reduce overnight investments to fund member withdrawal requests. The outflow of overnight investments results in the *average* maturity of total portfolio increasing for a short period. CenCorp believes that other restrictions within the proposed rule appropriately limit credit and liquidity risks. This two-year limitation is not necessary and should be eliminated.

Corporate Capital[1]

The existing Member Capital Accounts (MCAs) will no longer qualify as regulatory capital. Minimum qualifying capital requirements are based on the Basel standards that were developed for commercial banks. This includes a minimum 4% leverage ratio (same amount as the current total capital ratio) and a risk-based capital requirement (not part of the current rule). The new qualifying capital is not subject to periodic (annual) adjustment like existing MCAs and requires regulatory approval to redeem early (even if the Corporate exceeds the established capital requirements after the redemption). Unlike current Basel and GAAP standards, capital investments in subsidiaries/CUSOs must be immediately deducted from capital. The proposed rule also sets milestones for the building of retained earnings.

The NCUA's basic rationale for the proposed changes is that the permanence of capital and a risk-based capital standard would have mitigated the losses at Corporates in the past two years. In actuality, the losses incurred by Corporates resulted almost exclusively from losses on investments. The existing contributed capital accounts of members at Corporates absorbed losses in a similar fashion as the capital accounts defined under the proposed rule would have if they were in place previously. CenCorp would have complied with the risk-based capital requirements as presented if they had been in force previously. We believe other Corporates would have complied also. The capital impairments incurred by Corporate members would have taken place regardless of the form of contributed capital.

The NCUA is proposing to apply commercial banking capital standards to a wholesale cooperative system. The deduction of any capital invested in a Corporate CUSO and the future requirement that a portion of capital consist of retained earnings makes the capital definition even more restrictive than the Basel standards. Other provisions in the proposed rule limit the risks assumed by a Corporate to levels that are significantly less than a commercial bank. This is an inflexible capital structure, particularly when (1) you consider that there will likely be consolidation at Corporates and natural-person credit unions in the future and (2) you compare it to a similar system such as the FHLBs.

Coupled with the credit concentration limits and other proposed provisions, a Corporate has little opportunity to generate earnings. CenCorp doesn't believe it would meet the future minimum retained earnings requirements with the ALM restrictions in the proposed rule as written. We expect that many members would not likely elect to convert/recapitalize the Corporate with the limitations in the proposed rule.

Although the existing MCAs with a three-year notice provision have absorbed recent investment losses at Corporates, this time period is short in relation to the term of some Corporate assets. A five-year notice would be more appropriate for capital purposes. The aggregate capital levels proposed (4% leverage and 8% risk-based ratios) are appropriate. CenCorp believes that a five-year contributed capital structure as opposed to paid-in-capital would strike an appropriate balance for member and regulatory purposes. Redemptions by the Corporate should be allowed, provided the Corporate is meeting the minimum capital requirements after any redemption.

From a NCUSIF standpoint, contributed capital acts in the same capacity as retained earnings. The building of retained earnings is typically a decision made by the organization's Board with

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[1] This is covered primarily in Section 704.3, but also includes definitions in Section 704.2.

any concerns of the regulator handled through the regular examination process. CenCorp doesn't believe that the portion of capital that is retained earnings should be designated within the regulation. The retained earnings milestone in the regulation should be eliminated with any regulator concerns addressed during the examination process.

Regarding capital contributed at CUSOs, this should not be deducted from the capital ratios. This would be consistent with the treatment of capital investments under GAAP.

The proposed rule contains several references[2] that authorize the NCUA Director of the Office of Corporate Credit Unions to take action that varies from regulation at his/her discretion without any avenue for appeal. The consequences of such action could potentially be severe and we believe, at a minimum, there should be concurrence of this action from the NCUA Board or other senior staff at the NCUA.

Early Redemption of Member Certificates (Section 704.8(c))

The proposed rule limits the amount paid on the early redemption of a certificate to the principal amount of the certificate plus accrued interest. Under the existing regulation, a member redeeming a certificate early could receive more than that if market rates had moved lower since the certificate was issued. Corporate certificates "compete" with other securities available in the marketplace such as agency securities. These securities can be sold at a gain. This proposed limitation would put the Corporate certificates at a disadvantage versus other securities.

Due primarily to other provisions in the proposed rule, CenCorp expects to reduce the amount of longer-term certificates that it issues. This would reduce the impact of the new limit on early redemptions if it were included in the final rule. However, some other Corporates issue more certificates than CenCorp. This provision may restrict their funding sources and contribute to a liquidity concern in the future. CenCorp believes that the payment of gains on certificate redemptions doesn't add to risk and should be permitted. The prohibition on gains should be eliminated from the final rule.

Limit on Investment from an Individual Member (Section 704.8(k))

The proposed rule limits investments received from an individual member to 10% of a Corporate's assets. CenCorp doesn't have an individual member that exceeds this threshold. We believe that the risks of this type of concentration are already addressed in the other provisions in the regulations and this 10% limitation should be removed.

Issuer Concentration Limits (Section 704.6(c))

The proposed rule establishes a limitation on the investment in a single obligor (excluding certain investments like agency securities) equal to 25% of a Corporate's capital with certain exceptions. Corporates with payment system operations often present transit (forward collection) items through correspondent banks. These funds are initially credited to an account at the correspondent bank and then consolidated back to the Corporate when available. Because the majority of the transit items are images, the credit and movement of funds back to the

[2] Section 704.3(d)(4)(v), 704.3(e)(3), 704.4(d)(3), 704.4(d)(3)(ii), 704.4(d)(4) and 704.4(k)(2)(v).

Corporate occur on the same day. Accounts at correspondent banks that facilitate this type of payment system activity should be added as an additional exception to the single obligor limit.

Corporates are subject to fairly predictable but large inflow and outflow of deposits on a seasonal basis. The ability to invest a relatively large amount of funds (up to $1 billion at CenCorp) for several months during the year is necessary to provide an adequate return to members. These funds are reinvested primarily at the FRB or US Central today. We expect that these funds will need to shift towards Fed Funds transactions in the future. The 25% issuer limitation would require numerous counterparties as financial institutions continue to consolidate and reduce the investment options available. Considering the low risk profile of the Fed Funds market, we recommend that a single obligor limit of 200% of capital for transaction with maturities less than 90 days would be appropriate.

Slowdown in Investment Prepayment Speeds (Section 704.8(f))

The credit risk concentration limits and other provisions in the proposed rule will necessitate the movement of investments to other sectors in the future, including asset-backed securities (ABSs). The proposed rule calls for a new NEV limitation based on a 50% slowdown in the prepayment speed of securities. This includes ABSs secured by auto and credit card loans that historically have had little variability in their prepayment speeds. CenCorp believes that the interest rate risk limitations in Section 704.8 are sufficient and this 50% slowdown in prepayment speed should be eliminated.

Permissible Corporate CUSO (Section 704.11(e))

The proposed rule limits CUSO activities to brokerage, investment advisory or other activity approved by the NCUA. It doesn't address existing CUSOs at Corporates. CenCorp has a business services CUSO that has been in operation for over five years. This would require NCUA approval under the proposed rule. CenCorp suggests that existing Corporate CUSO operations be grandfathered in the proposed rule.

Borrowing Limitation (Section 704.9(b)(1))

Borrowing is limited to 30 days for "liquidity purposes" in the proposed rule. CenCorp has historically borrowed funds for a few weeks during its low liquidity period in late summer. It has also borrowed to offset the interest rate risk of term (over one-year) loans to members with similar term borrowings. As written, this latter activity would be prohibited. It would also restrict a Corporate from borrowing for over 30 days even if it were better economically. CenCorp believes that other provisions in the proposed rule adequately encompass any ALM or liquidity concerns involving borrowing and that this provision should be deleted.

Board Member Terms (Section 704.14(a)(4))

The proposed rule limits Corporate Board members from serving over six years. If applied, the average tenure of the Board would be expected to move towards three years as the rule is completely phased in. From CenCorp's perspective, the majority of its existing Board members would not be able to seek re-election when their term expires. We believe that imposing term limits would be disruptive to CenCorp's ongoing governance and doesn't add any value. We believe term limits should be deleted.

Effective Dates for Transition

As indicated in the proposed rule, the effective date of most provisions is immediately upon publication of the final rule. Without knowing what the final rule will entail, an immediate effective date will likely put a Corporate into non-compliance regarding some provisions. For example, CenCorp's business services CUSO is not permitted under the proposed rule as written. CenCorp wouldn't know if it is actually not permitted until the final rule is published. It would not be in compliance at that point. CenCorp suggests that adequate time be incorporated into the final rule to allow for transition.

Conclusion

The experience of recent years indicates a need for changes at Corporates. These changes are being considered at a time of great uncertainty in the financial markets and in the valuation of investment securities owned by Corporates. An effective regulatory framework limits the aggregate risks that can be assumed by a Corporate while allowing the risks to be managed for the benefit of members. It is balanced.

The proposed rule restricts Corporate operations to the point that little risk is assumed. The restrictions are such that they don't allow a Corporate to have the authorities/tools needed to generate much value on behalf of members. CenCorp believes that substantial modifications to the proposed rule are needed to get to an appropriate balance.

If you have any questions regarding any of the items above, please contact me at (248) 304-3004 or bwalby@cencorpcu.com.

Sincerely,

William A. Walby
Chief Executive Officer

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