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

Subject: Comments on Part 704 Corporate Credit Unions

Dear Ms. Rupp:

I am writing on behalf of the CoastHills Federal Credit Union and appreciate the opportunity to comment on NCUA's proposed amendments to Part 704, which would make major revisions regarding corporate credit union capital, investments, asset-liability management, governance, and credit union service organization (CUSO) activities.

CoastHills serves the residents and communities of San Luis Obispo County and northern Santa Barbara County in California with 11 branches, 200 employees and 65,000 members. Our corporate credit union (WesCorp) plays a key role in providing CoastHills with trading, payments, clearing, and settlement services, as well as investment and liquidity options. We have suffered greatly from the conservatorship of WesCorp, its capital depletion and impending insurance premium assessment. In addition to the corporate challenges, CoastHills is dealing with plummeting housing prices (30%-70% declines) and skyrocketing unemployment (10%-16%). We are considered a big fish in a small pond in our field of membership and, despite the challenges of our corporates and the economy, we continue to make a difference in our communities every day.

I recognize that the NCUA Board and staff have spent an enormous amount of time, effort, and consideration in researching, discussing, soliciting and evaluating input, and creating the Advanced Notice of Proposed Rulemaking and this proposed rule. NCUA's desire to improve and strengthen the corporate system is evident in the scope and breadth of this proposal. However, it appears that the proposal raises far more substantial concerns than it provides realistic solutions. There are several provisions that, if enacted as proposed, will make it essentially impossible for corporate credit unions to operate in a viable fashion. Further, many of these provisions will have harmful effects on natural person credit unions and, ultimately, their members.

I urge the NCUA to withdrawal the proposal as drafted so that a more cohesive and feasible set of rules can be crafted. I strongly believe that *there should be another round of proposed rule making for Part 704—with another 90 day comment period—before issuing final rules to govern corporate credit unions*.

My comments are organized as follows:

- ***Critical Issues of Concern***

1. Time Period for Capital Ratio Attainment
2. Retained Earnings Growth Model
3. Average-Life NEV Testing
4. Weighted Average Asset Life
5. Legacy Assets
6. Qualifications of Directors
7. Risk-Based Net Worth for Natural Person Credit Unions
8. Consolidation of Corporate Credit Unions

- ***Other Areas of Concern***

9. Premium for Early Withdrawal on Corporate Certificates
10. Perpetual Contributed Capital
11. Payment of Dividends
12. Concentration Limits
13. Corporate Credit Union Service Organizations
14. Credit Ratings
15. Overall Limit on Business Generated from Individual Credit Unions
16. Disclosure of Executive and Director Compensation
17. An Extra Line of Defense between Corporates and Natural Person Credit Unions

Critical Issues of Concern

If the following issues are left unchanged, there will be severe, and possibly unrecoverable, repercussions to corporate credit unions, which in turn would have harmful effects on the natural person credit unions that rely upon them.

<u>1. Time Period for Capital Ratio Attainment</u>
As drafted, the one year window required by the proposal to attain the risk-based capital ratios (i.e., the 4% Leverage Ratio) will require corporates to bring in new capital or, at a minimum, convert existing MCA to the new PCC during a time when significant issues remain unresolved regarding legacy assets. Due to a lack of sufficient retained earnings at most corporates, and an inability to grow retained earnings at a rate required by the proposed rule (see discussion below), member credit unions will likely be asked to contribute approximately 4% of the corporate credit union deposits as perpetual capital within 12 months of the publication date of the final rule.

No credit unions will be willing to contribute additional capital in such a short time frame, and in such an uncertain environment. Indeed, some credit unions may decide to pull their deposits from the corporate system as the result of such a precipitous move to achieving a 4% Leverage Ratio via PCC. This, in turn, would lead to liquidity concerns for corporates.

Recommendation: NCUA needs to clarify its intention with respect to the time period for capital ratio attainment. Given the unavoidable reality that credit unions will need longer than one year before they will feel comfortable recapitalizing corporates. NCUA should recognize that: (a) some kind of financing or capital note (equivalent to 4% of a corporate's balance sheet) will be required to meet corporates' operational needs; and (b) the proposal's time period for attaining the risk-based capital ratios must be extended to at least three years.

2. Retained Earnings Growth Model

NCUA's assumptions regarding a corporate's ability to grow retained earnings under the proposed investment and ALM limitations (pages 99-101 in the proposed rule), does not represent a reasonable or attainable mix.

NCUA Model

	NCUA EXAMPLE	
	PERCENT OF BALANCE SHEET	**SPREAD TO LIBOR**
ASSETS		
FFELP Student Loans	20%	25
Private Student Loans	10%	200
Auto ABS	20%	25
Credit Card ABS	10%	30
Other ABS	10%	10
Overnight	30%	0
TOTAL	100%	**34**
SHARES AND EQUITY		
Overnight Shares	30%	0
Certificates	70%	0
Capital Notes	0%	0
TOTAL	100%	0
NET INTEREST MARGIN		**34**
OTHER INCOME		**17**
OPERATING EXPENSES		**30**
NET INCOME		**21**

For example, NCUA's model appears to work because it allocates 10% of the investment portfolio to a fairly high risk, extremely illiquid sector – private label student loans. This is on top of a 20% allocation in government guaranteed student loans. We believe it is unrealistic and unsound to allocate 30% of a portfolio to the student loan sector. (In fact, it is doubtful that a corporate could even find enough of these risk assets to make such a model work.) This single sector of NCUA's model accounts for an astonishing 75% of the interest income. Even more startling is the realization that private student loans (10% of the portfolio) account for 68% of interest income and, subsequently, 39% of net income. This is untenable.

In addition, the model assumes funding using a deposit mix of 30% overnight shares and 70% certificates. This assumption is not valid, as other provisions of the proposal (e.g., the early withdrawal premium provision for certificates) will serve to create a major disincentive for corporate term funding. Finally, the model does not provide any cost of capital in its assumptions. This baffling omission further weakens the credibility of the retained earning growth outcomes presented.

The proposed model violates principles of concentration risk, represents too much exposure, and is far-removed from attainable, real-world results. Further, the model appears to provide little opportunity for diversification, which will make retained earnings growth that much more difficult to realize. It is apparent from these assumptions that NCUA is attempting to *eliminate* risk at the corporate level, as opposed to permitting corporate credit unions to *manage* risk. Such a business model is unreasonable and counterproductive and, ultimately, will be crippling to the corporate network. For example, without an ability to generate earnings from investment risk, corporates will not be able to keep payment system fees down, forcing a move from a cooperative payment system pricing model to a market-based, for-profit model. This will have a pronounced effect on natural person credit unions, as they will be saddled with much higher fees (we have seen analysis which indicates a potential increase in fees of 2 to 3 times current levels), as well as the possibility of obtaining and maintaining new payment services relationships.

The adjusted model below created by the Association of Corporate Credit Unions (ACCU), illustrates a more realistic outcome, and highlights the need to make necessary revisions to the proposed assumptions and limitations. This model is based on a $10 billion dollar balance sheet for example purposes and assumes no growth in assets or asset mix. Spreads are adjusted downward by 2 or 3 bps over the 7-year time horizon to reflect industry expectations. Funding has been modified to include a capital note of $400 million (4% capital assuming a $10 billion balance sheet) issued on day one, priced as floating at a spread of 200 bps to LIBOR. The adjusted model also assumes that fees and operating expense will increase in line with inflation at an assumed rate of 2% per annum.

NCUA Model Adjusted for Capital and Spreads

	NCUA EXAMPLE		ADJUSTED FOR CAPITAL		ADJUSTED FOR SPREAD	
	PERCENT OF BALANCE SHEET	SPREAD TO LIBOR	PERCENT OF BALANCE SHEET	SPREAD TO LIBOR	PERCENT OF BALANCE SHEET	SPREAD TO LIBOR
ASSETS						
FFELP Student Loans	20%	25	20%	25	20%	25
Private Student Loans	10%	200	10%	200	10%	**50**
Auto ABS	20%	25	20%	25	20%	25
Credit Card ABS	10%	30	10%	30	10%	30
Other ABS	10%	10	10%	10	10%	10
Overnight	30%	0	30%	0	30%	0
TOTAL	100%	**34**	100%	**34**	100%	**19**
SHARES AND EQUITY						
Overnight Shares	30%	0	30%	0	30%	0
Certificates	70%	0	66%	0	66%	0
Capital Note	0%	0	**4%**	**200**	4%	**200**
TOTAL	100%	**0**	100%	**8**	100%	**8**
NET INTEREST MARGIN		**34**		**26**		**11**
OTHER INCOME		**17**		**18**		**18**
OPERATING EXPENSES		**30**		**32**		**32**
NET INCOME		**21**		**12**		**-3**

As the adjustments for capital costs, LIBOR spreads, and operating expenses indicate, rather than realizing positive net income of 21 bps, the hypothetical corporate credit union would realize negative net income of -3 bps.

The following alternative model by ACCU illustrates probable investment portfolio performance over a 6-year period using realistic and prudent sector mixes and spreads:

Longer-Term Analysis Projected Over 6 Years

LONGER-TERM ANALYSIS

	BASE EXAMPLE			REQUIRED VOLATILITY	
ASSETS	PERCENT OF BALANCE SHEET	SPREAD TO LIBOR		PERCENT OF BALANCE SHEET	SPREAD TO LIBOR
Loans	10%	50		10%	50
ABS - Autos	20%	37		20%	37
ABS - Credit Cards	15%	42		15%	42
FFELP Student Loans	5%	45		5%	45
Structured Agency	15%	34		15%	34
Bank Floaters	5%	29		5%	29
Other Short-term	8%	12		8%	12
MBS - CMBS	7%	100		7%	100
Overnight	15%	4		15%	4
TOTAL	100%	**36**		100%	**36**
SHARES AND EQUITY					
Overnight Shares	50%	0		50%	0
Certificates	46%	0		46%	0
Capital Note	4%	200		4%	200
RUDE	0%	0		0%	0
TOTAL	100%	**8**		100%	**8**
NET INTEREST MARGIN		**28**			**28**
OTHER INCOME		**18**			**18**
OPERATING EXPENSES		**32**			**32**
NET INCOME		**14**			**14**

MAXIMUM CHANGES YEARS 1,3 AND 6

RETAINED EARNINGS	PROJECTED	TARGET	RETAINED EARNINGS	PROJECTED	TARGET
YEAR 3	$44.4mm	$45mm	YEAR 3	$44.4mm	$45mm
YEAR 6	$97.3mm	$100mm	YEAR 6	$97.3mm	$100mm
NEV SHOCKS	**MAXIMUM**	**LIMIT**	**NEV SHOCKS**	**MAXIMUM**	**LIMIT**
RATES +300bps	-14.0%	15%	RATES +300bps	-14.0%	-15%
CREDIT +300bps	-84.3%	15%	CREDIT +100bps	-30.3%	-35%
+PAYDOWNS -50%	-92.6%	25%	+PAYDOWNS -50%	-32.7%	-40%

In summary, with an investment mix that includes loans, ABS-Autos, ABS-Credit Cards, FFELP Student Loans, Structured Agency, Bank Floaters, Other Short-term, MBS-CMBS, and Overnight, it is projected that net income of 14 bps can be realized. However, even this margin would be insufficient to meet the proposed capital targets. Even at 14 bps, a corporate would be short 7 bps of NCUA's model projected net income of 21 bps.

<u>Recommendation</u>: NCUA should provide an independent, third-party "proof of concept" validation of the Agency's business model presented in this proposal or any alternative proposal. A proper assessment must do more than just "test the math." A credible assessment will test the assumptions and ultimate viability of the proposed business model.

Beyond the obvious failings of the proposed retained earnings growth model, there are concerns about the broader implications of what is reflected in this section. It appears that NCUA envisions the shrinking of corporates' balance sheets. Such movement would not only represent a fundamental change to the corporate business model—a fact which lies unaddressed by the Agency in its proposed model and assumptions—but would also result in a shifting of the investment function to natural person credit unions. Obviously, corporates possess far more in the way of experience, expertise, and resources (e.g., people and software) to manage this function than does the typical natural person credit union. Such a "managing down" of corporate balance sheets to the natural person credit union tier would introduce greater instability, risk, burden, and costs into the credit union system, and would pose ever greater risk and losses to the NCUSIF. This consequence of NCUA's retained earnings growth model proposed is alarming and a further indication of the impractical and non-synchronous nature of the proposal. One need only recall the horrific investment losses associated with Penn Square Bank and Ginnie Mae in the early 1980s to question the advisability of pushing the investment function back down to NPCUs. Surely, NCUA cannot have intended to introduce greater risk at the natural person credit union level and greater losses to the share insurance fund.

<u>Recommendation</u>: Given the severe risks posed to natural person credit unions and the share insurance fund, NCUA should consider the unintended consequences of pushing the investment function down to natural person credit unions that, for the most part, lack adequate expertise to safely manage investment portfolios.

<u>3. Average-Life NEV Testing</u>

The proposal requires average-life mismatch net economic value (NEV) modeling/stress testing, in addition to existing interest rate risk (IRR) NEV modeling, to include:

- A 300 basis point credit spread widening, coupled with a NEV ratio decline limited to 15 percent;
- A 50 percent slowdown in prepayment speeds to determine if the corporate has excessive extension risk; combined with
- A portfolio/asset limit of two years in average weighted life.

The analysis is troubling as there is no combination of assets—with a two-year average life and limited extension risk—that could generate sufficient margin to attract funding *and* pass a 300 basis point credit shock test. Further, the proposed limitations placed upon a corporate by these tests would not allow corporates to generate sufficient interest margin to build retained earnings to meet the new capital requirements contained in the proposal. (The 2-year average weighted life limitation will make holding Agency and Private Label Mortgage Backed Securities—the largest sector of potential investments—virtually impossible for corporates.) Any ability to generate a reasonable interest margin in order to build retained earnings will become very dependent upon a lower cost of funds for corporates, which means a lower yield paid to members.

The proposed spread widening of 300 bps appears to be an over-reaction by NCUA to a once-in-a-lifetime, completely unique event. Historical analysis indicates that, over the past 15 years, excluding recent events, credit card and auto ABS credit spreads to LIBOR widened to a maximum of approximately 50 bps, and generated a standard deviation of spread volatility of approximately 10 bps.

Recommendation: It would be more realistic to set the credit shock test at 100 bps widening – double the historical average. Even at 100 bps credit shock, a NEV volatility limit of 35 percent decline is needed to accommodate the impact of floating-rate investments carrying the loss to maturity. Therefore, NCUA should amend this test to a 100 bps credit spread widening and a 35 percent NEV volatility tolerance limit.

4. Weighted Average Asset Life

This provision limits the weighted average life (WAL) of a corporate credit union's aggregate assets to two years and includes loans to members. Such a requirement will have adverse implications for natural person credit unions seeking to fill liquidity needs with term loans from corporates. In order to keep the overall WAL of its portfolio within the two-year limit, most of the loans made by a corporate will be limited to shorter-term maturities. For longer-term loans, a corporate will have to substantially increase the rate offered in order to compensate for the impact the longer term will have on its two year WAL test.

As a result, long-term financing to natural person credit unions will be drastically reduced, and will come with a much higher borrowing cost. Currently, less than 25% of California and Nevada credit unions are members of the FHLB. The remaining credit unions rely on a corporate to obtain term lending. Therefore, the two-year proposed limitation will force credit unions to seek less beneficial, or more expensive, funding from other sources. In addition, many natural person credit unions use longer-term borrowings to mitigate interest rate risk. A limitation on borrowings from corporates to two years would take away an important tool for these credit unions.

Recommendation: NCUA should exclude loans from the calculation of weighted average life of the investment portfolio. After all, the original purpose of corporate credit unions was to enable financial intermediation between credit unions—not only their short term needs but also medium and long term needs. Whatever changes NCUA makes to the WAL of corporate assets, it must consider appropriate adjustments to the liabilities side of corporate balance sheets.

5. Legacy Assets in Corporate Credit Unions

Although NCUA has made public statements indicating that it will announce plans in April 2010 for addressing legacy assets, it is concerning that this critical topic is not mentioned at all in the proposed rule. Dealing with investment securities remaining on corporates' books is vital to realizing any lasting, consequential changes to the corporate system. These assets—by some estimates believed to represent as much as $30 billion in eventual losses, or one-third of all natural person credit union net worth—continue to create instability in the network, and serve as a major disincentive to credit unions providing any future capital contributions. No credit union will invest unless the toxic assets are segregated so that new capital is not at risk. We believe that failure to address this issue invites the weakening of even currently stable corporates, and would serve to negate the positive changes that NCUA and credit unions would like to see in the corporate system.

Recommendation: NCUA should cooperatively and transparently address the business and regulatory issues associated with these assets so that corporate credit union balance sheets can start with a "clean slate," rather than from a negative position. In addition to the proto-typical assets on corporate balance sheets, NCUA should also address any problem assets that may reside on the balance sheets of corporate credit union service organizations.

6. Qualifications of Directors

The proposal requires, as qualification for directorship, that all candidates must currently hold the equivalent of a CEO, CFO, or chief operating officer (COO) position at the member institution (typically, though not always, a natural person credit union). A particular job title does not necessarily make for a better board member, and suggests that NCUA consider that directors of corporates that may not have full experience or training needed in a particular area be required to obtain training on an annual or other periodic basis as a condition of service on a corporate board. There are a variety of credit union training programs, schools, online resources for board members which the NCUA could evaluate (possible every one to two years) and approve for use to meet such a standard. The goal should be that directors serving on a corporate credit union board have sufficient "skin in the game" and analytical ability to effectively look after member credit unions' interests.

As for term limits, a maximum of nine years (as compared to six) provides a more reasonable and useful time for training and developing directors as well as for benefiting from the investment in their development. Extending the term limit to nine years further allows for much needed continuity for a corporate without compromising the benefits that may be realized from bringing on new directors.

Recommendation: The proposed six-year term limit for corporate directors should be changed to a nine-year limit. Further, outside directors with investment expertise should be permitted to serve, as long as adequate safeguards are in place to address conflicts of interest between an outside director's professional investment interests and his/her responsibility to preserve the confidential and proprietary interests of a corporate credit union.

7. Risk-Based Net Worth for Natural Person Credit Unions

NCUA should support adoption of risk-based capital among corporate credit unions. Corporate credit unions and natural person credit unions, alike, have been operating in an outdated capital framework that is out-of-step with the broader financial sector and worldwide financial regulatory regimes. While it is beyond the scope of Section 704, there is an opportunity for risk-based capital be extended to natural person credit unions. As the corporate credit union meltdown clearly reminded the entire credit union system, not all assets are created equal and NCUA should modernize its measurement of capital adequacy to reflect the degree of risk associated with different assets. This change is fully within NCUA's regulatory authority, is low risk, and would provide many credit unions with relief while still maintaining strong and credible credit union net worth standards.

Recommendation: NCUA should exercise its regulatory authority to update the capital framework for natural person credit unions to align with the broader financial sector by extending risk-based net worth to natural person credit unions.

8. Consolidation of Corporate Credit Unions

Corporate consolidation would be beneficial to the system, and NCUA should be more open, responsive, and supportive of such consolidation by removing unreasonable impediments and/or resistance to corporate credit union mergers. The current number of corporates is less than ideal with respect to efficiency and effectiveness (e.g., potentially redundant member capital requirements, duplication of expertise, staffing, and infrastructure). Instead of NCUA avoiding taking a stance on the number of corporates in the system, it should move to a more open dialogue between NCUA, corporates, and credit unions regarding consolidation scenarios including the effect it would have on the viability of the entire credit union system. In identifying the "best" business model for corporates in the future, it is worthwhile to contemplate how much stronger and more valuable corporate credit unions would be to the nation, credit unions, and consumer-members if they adopted an FHLB-type model wherein corporates could raise money from selling bonds with the full faith and credit of the Treasury to support consumer and small business lending.

Recommendation: NCUA should have a frank and candid discussion with all parties—possibly as part of a subsequent round of rulemaking—about the efficiency, effectiveness, and sustainability of a single corporate credit union with multiple regional offices. We believe that such a discussion should include the assessment of elements of the Federal Home Loan Bank model that might be successfully imported into the corporate system.

To summarize, I firmly believe that the NCUA should forego finalizing the above critical issues in their current proposed form, and should carefully assess all comments and analysis NCUA receives from commenters regarding the viability and reasonableness of the tests and the two year average weighted life limitation, as well as the capital ratio attainment and the retained earning growth assumptions. NCUA should also review whether historical trends justify the proposed tests and thresholds. Further, NCUA should transparently clarify how it intends to deal with legacy assets that remain on the books of corporate credit unions and what impact there will be on natural person credit unions upon the disposition of assets in question. Lastly, I believe that, in the spirit of transparency and fairness, NCUA should publicly provide its modeling tool and/or assumptions. Doubts and concerns regarding these proposed provisions are further amplified when you consider that NCUA may choose to incorporate them into planned revisions to Part 703, which will have similar, debilitating effects on natural person credit unions.

Other Areas of Concern

9. Premium for Early Withdrawals on Corporate Certificates

This proposed provision limits a corporate credit union's ability to pay a market-based redemption price to no more than par, thus eliminating the ability to pay a premium on early withdrawals. Such a change will pose a significant disincentive for member credit unions seeking liquidity, and will likely lead them to seek more competitive investing options than corporates. Many smaller credit unions take advantage of a non-penalty option to manage liquidity, especially if they do not invest in securities.

Such a change will also have the effect of increasing corporates' funding costs. Even if a corporate desired to raise their yield in order to compete, it would be unlikely that they could generate sufficient earnings to cover the increased rate. As a result, corporates' institutional funding market for term certificates will be severely impaired—or even wiped out—which will lead to a significant reduction in overall liquidity in the corporate credit union system.

Recommendation: NCUA should strike this proposed requirement from the final rule, as it is not only counterproductive to maintaining corporate liquidity and natural credit union investment options, but would likely have long-lasting and harmful effects to the system.

10. Perpetual Contributed Capital

I support eliminating the current prohibition on a corporate requiring credit unions to contribute capital to obtain membership or receive services. (In other words, a corporate can choose or not to require credit unions to contribute capital in order to receive services from that corporate.) Leaving this decision to the board and management of a corporate credit union provides appropriate flexibility, and I applaud NCUA for proposing this change.

Caveats: However, there is a concern that many credit unions remain wary of contributing additional capital during these still-unsettled times. This wariness is sharpened in the case of WesCorp, as the degree and duration of NCUA's conservatorship remains undefined. Further, in the event a corporate cannot earn their way into building retained earnings—and, as we indicated earlier, we believe that such an outcome is not likely under the proposed rules—concerns have been raised by credit unions about the possibility of a forced capital contribution. Again, these issues highlight that it is imperative for NCUA to carefully consider the impact of this proposal in all its aspects –not only each provision on its own, but also the effect each provision will have when put into play with all other provisions in the proposal. When this is done, it becomes apparent to us that the proposal is unworkable in its current form.

11. Payment of Dividends

The proposal will prohibit an undercapitalized corporate, unless it obtains NCUA's prior written approval, from paying dividends on capital accounts. A blanket prohibition is counter-intuitive and potentially counter-productive for the future re-capitalization of the corporate credit union system. Capital accounts, as natural person credit unions have painfully learned, are riskier than insured deposits. To balance that higher risk, investing credit unions will be reluctant to contribute capital without the promise of a higher return to compensate for the added risk. Indeed, in public comments, NCUA officials have observed that past behavior of corporate credit unions and natural person credit unions with regard to administration of corporate capital accounts, had been "backwards" in that lower returns were being paid and accepted on riskier investments.

While the operational questionability of paying dividends on paid-in capital when an undercapitalized financial institution needs to maximize retained earnings to build capital, this is a case-by-case decision properly made by the board and management of a corporate credit union in the context of the interest rate environment at a given moment in time. Further, the proposed retained earnings target will serve as a built-in constraint on paying dividends.

Recommendation: NCUA should not impose a blanket prohibition on undercapitalized corporates from paying dividends on capital accounts. NCUA should, instead, rely on a retained earnings target—to be developed, presumably, in the next round of proposed rule-making—to serve as a built-in constraint on the payment of dividends.

12. Concentration Limits

As written, Federal Funds transactions are not specifically excluded from the sector concentration limits. As a result, corporates would have severely limited access to the federal funds market. This will have the harmful effect of reducing the overnight rates that member credit unions receive from their corporate. In addition, it would reduce natural person credit union ability to access or engage in a market-based overnight investment option.

Recommendation: To address this, the definition of deposits in 704.6 (d) should be amended to include Federal Funds or, alternatively, that the exemptions from sector concentration limits include Federal Funds transactions. Also, 704.6(c) should be changed to allow a larger single obligor limit of 200% of capital on money market transactions with a term of 90-days or less. An alternative solution might be to specifically allow a single obligor limit of 200% of capital for Federal Funds transactions sold to other depository institutions.

13. Corporate Credit Union Service Organizations

The section of the proposal adds a very short list of permissible corporate CUSO activities (consisting of brokerage services, investment advisory services, and other categories as approved by NCUA). NCUA should be more clear in the form of definitions or additional information regarding permissible activities, which are surprisingly scant and inadequately defined in the proposal. Further, it is unclear what would happen regarding corporate CUSOs which currently engage in activities not listed in the proposal. Would these activities be grandfathered? Would the NCUA subject them to an approval process? We believe these issues must be addressed in order to avoid credit union uncertainty or concern regarding services provided by these CUSOs.

This section of the proposal also provides for expanded access by NCUA to a corporate CUSO books, records, and facilities. While NCUA has unparalleled skill and knowledge in examining credit unions, this expertise would not necessarily translate into efficient and effective examination of other business entities, and other business products. Indeed, some CUSOs and their activities are already examined by state regulatory agencies, so NCUA oversight would be a redundant and inefficient use of the Agency's resources. In the case of a CUSO with both state and federal credit unions owners, NCUA has access to the CUSO's books and records through the federal credit union owner(s).

I disagree with a blanket expansion of access to CUSOs by NCUA especially where potential losses do not meet the test of materiality. However, I do understand that there may be situations—such as CUSO activities which involve greater risk to a corporate, and/or in situations where a corporate has a controlling interest in a CUSO—which warrant greater access by the Agency. For example, CMBS and SimpliCD may pose the threat of *material* losses in contrast to a corporate's minority interest in MDC or CUDL. In addition, I appreciate that NCUA's objective may be to limit corporate ability to shift non-performing assets off-balance sheet through corporate CUSOs.

Recommendation: NCUA should clarify definitions or additional information regarding permissible CUSO actitivities and the grandfathering of current but unlisted CUSO activities. Also, NCUA should utilize the concept of "materiality" to determine the extent of NCUA's access to CUSO books, records, and facilities. NCUA's reach should be restricted to CUSO activities that represent material risk.

14. Credit Ratings

NCUA's de-emphasis of NRSRO ratings and the use of ratings in order to exclude an investment, not as authorization to include an investment is apppreciated. However, the requirement to obtain multiple ratings may be problematic, as some securities only have one NRSRO rating. This would limit some investment options for corporates and, if this requirement is also implemented in Part 703, natural person credit unions. In any case, it is important to stress that credit ratings are only one of several tools that corporates and natural person credit unions should utilize to evaluate risk.

Recommendation: NCUA should consider permitting an exception to the multiple rating requirement in situations where there is only one rating and, more broadly, to provide further elaboration in the proposal on what standards, methods, or tools corporates should use in analyzing credit ratings.

15. Overall Limit on Business Generated from Individual Credit Unions

This provision prohibits a corporate from accepting from a member credit union *or other entity* any investment in excess of 10 percent of the corporate's daily average net assets, with the objective of reducing risks that could arise from placing undue reliance on a single entity. Such a limitation—from an individual credit union standpoint—is prudent and reasonable from a liquidity management standpoint. However, many corporates avail themselves of inter-month funding when needed to address short-term liquidity volatility. Typical sources of these funds include the Federal Reserve Bank and the Federal Home Loan Bank. Therefore, including "or other entities" in the 10 percent limit may force corporates into short-term borrowing with less favorable terms. It would force corporates to maintain larger cash balances, which would likely be detrimental to earnings. This provision, as written, may limit corporates' ability to provide their credit unions with reasonably priced short-term liquidity.

Recommendation: NCUA should consider allowing borrowings with a maturity of 30 days or less from either the Federal Reserve Bank, a Federal Home Loan Bank, a Repurchase Agreement counterpart or a Federal Funds counterpart, in excess of 10% of the corporate credit union's moving daily average net assets. Alternatively, since the objective is to limit risk associated with a single *credit union*, this issue could be most simply addressed by eliminating the "or other entity" language of the proposed limitation.

16. Disclosure of Executive and Director Compensation

The requirement to disclose all compensation between a corporate and its senior executives — defined as a chief executive officer, any assistant chief executive officer (e.g., any assistant president, any vice president or any assistant treasurer/manager), and the chief financial officer—goes deeper than industry requirements for banking counterparts and, for a large, complex corporate with many vice presidents and assistant managers, could mean disclosure of compensation for non-executive staff. This requirement goes well beyond expected and necessary practice. As NCUA has indicated that this provision mirrors IRS Form 990 with regard to information and access process, it is sensible and desirable for NCUA to align its compensation disclosure requirements with IRS Form 990 guidelines.

Recommendation: Per IRS practice, NCUA should define "senior executive" in this provision to conform with Form 990 definitions (e.g., "officers," "key employees") and limitations (e.g., only over $150,000 reportable compensation for key employees). Consistent with the Form 990 disclosure requirements, NCUA should require compensation disclosures *upon request only* rather than require annual outward reporting of compensation which can be abused by the press to the detriment of the credit union system. Furthermore, corporates should only be required to honor compensation disclosure requests made by bonafide members of the corporate. In lieu of outward annual reporting of compensation information, corporates could annually announce the *availability* of compensation information upon member request.

17. An Extra Line of Defense between Corporates and Natural Person Credit Unions

In our ANPR comment letter of April 2009, we urged NCUA to consider the erection of a more robust "firewall" or "buffer" between corporate credit union risk and natural person credit union (NPCU) safety. NCUA might consider the creation of a separate insurance fund or separate insurance "system" for corporate credit unions in the future. Since then, NCUA officials have stated that decoupling of corporate and NPCU insurance coverage would *not* have insulated NPCUs from the corporate credit union meltdown. That is, the liquidation of corporates would have wiped out not only NPCUs' PIC and MCA but also NPCU *uninsured* deposits to the tune of total losses upwards of $30 billion rather than the $6 billion ultimately associated with the corporate losses. To be sure, hypothetically, even if corporates were separately insured, any losses by a natural person credit union on uninsured corporate investments that caused the natural person credit union to fail would then cause losses to the share insurance fund and all other credit unions. It is understood that all credit unions and their losses are linked through the insurance fund.

Still, NCUA should explore other options for creating a line of defense between corporates and NPCUs. Although a number of Federal Home Loan Banks are known to have invested in similarly toxic securities and have found themselves in highly weakened capital positions, no credit unions nor their bank counterparts have lost stock held in FHLBs—a looming contrast to capital lost by NPCUs in the credit union corporate system. Admittedly, FHLBs are "a different animal" in that they are government-sponsored entities; however, like corporate credit unions, FHLBs are privately capitalized.

Under FHL Banks' newly formed regulator, the Federal Housing Finance Agency (FHFA), capital adequacy in this period of financial sector and economic stress has been measured by "regulatory capital" instead of GAAP-based capital. "Regulatory capital," according to SubsidyScope, does not count the losses that a FHL Bank suffered on its mortgage-backed securities. Thus, the FHLB of Seattle, for example was allowed to state a capital position of nearly $3 billion with only $960 million in GAAP-based capital. This critical tool of "regulatory capital" that was employed by the FHFA created an effective "line of defense" between investors (i.e., investing credit unions and banks) and those FHL Banks that held problem assets.

Last year the NCUA Board issued an order to permit corporate credit unions to use their capital level as reported on their November 30, 2008 Call Report, for purposes of determining compliance with regulatory capital requirements. This was a much needed action and the I encourage NCUA to further explore and actuate a more lasting, flexible approach regarding tools of this nature, whether to create a line of defense between investing credit unions and corporates, or to enable natural person credit unions to weather recessionary times and a protracted period of slow economic recovery.

To this end, we wish to highlight two salient comments regarding this very issue which were made by Robert H. Herz, Chairman of the Financial Accounting Standards Board, at an AICPA Conference in December 2009:

> [I]n my view, there should be a *greater decoupling of bank regulation from U.S. GAAP reporting requirements.* Doing so could enhance the ability of both the FASB and the regulators to fulfill our critical mandates. We can continue to work

> with independence and an unwavering dedication to market transparency; at the same time the bank *regulators can utilize their authority to take whatever actions are required to keep the financial system stable and healthy*. [Emphasis added.]
>
> Handcuffing regulators to GAAP or distorting GAAP to always fit the needs of regulators is inconsistent with the *different purposes of financial reporting and prudential regulation*. [Emphasis added.]
>
> *-Robert H. Herz, FASB Chairman, December 2009*

Ultimately, 90 million credit union members rely on the corporate system to provide trading, payments, clearing, and settlement services for their local credit unions. Given this *systemically* important role that the corporate credit union network plays in our nation's "financial plumbing," it would appear that preservation of a corporate credit union option is tantamount to preserving the credit union option, locally, for everyday consumers in our country.

Recommendation: NCUA should utilize its regulatory authority to redefine the definition of "total assets" under §702.2(g) of the Prompt Corrective Action rule to exclude guaranteed or low/no-risk assets from net worth ratio calculations. The following assets should be excluded from "total assets" for the calculation of net worth:

- Cash
- Overnight investments in corporate credit unions
- CU SIP deposits in corporate
- Corporate CU CDs
- Insured institutional certificates of deposit
- Guaranteed student loans
- Share secured loans
- Guaranteed portion of SBA loans
- Shares and loans guaranteed by the government
- Other government/recourse loans
- Accrued interest of non-risk investments
- Loans purchased from liquidating credit unions
- Assets held with options to sell to government
- Loans under Corporate CU Loan Guarantee Program
- GNMA/FNMA/FHLMC (GSE) securities/bonds
- U.S. Treasuries
- Furniture, fixtures, and equipment
- Land and buildings

In closing, I want to thank the NCUA Board for the opportunity to provide our concerns and recommendations regarding this very important rulemaking. I urge the Board to strike an effective and fair balance between preventing a repeat of past corporate failures and allowing a viable corporate system to thrive. To repeat, we ask NCUA to withdraw this proposal and consider another round of proposed rule-making with a 90-day comment period by the credit union system before issuing final rules. The gravity of possibly losing the corporate credit union system as an option for natural person credit unions justifies a comprehensive "reality check" on what NCUA has proposed for the future of corporate credit unions and, ultimately, natural person credit unions.

Sincerely,

Jeff York
President/CEO
CoastHills Federal Credit Union