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"Making a Difference in our Members' Lives"

MAR10'10 PM 3:08 BOARD

March 8, 2010

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

Subject: Proposed Regulation 12 CFR Part 704

Dear Ms. Rupp:

Proposed Regulation Part 704 pertaining to corporate credit unions has the potential to significantly affect our credit union. We have concerns with some of the limitations that would impact the ability of corporate credit unions to continue to offer the services that our credit union needs.

Currently, our credit union uses corporate credit unions for the following services:

- Overnight deposits
- Investments
- Lines of credit
- Wire transfers
- Asset-liability management consulting services

We are concerned that the proposed rule will force our credit union to seek services from alternative and likely more costly providers instead of from a corporate credit union owned by credit unions. We are concerned about the ability of corporate credit unions to continue to service natural person credit unions competitively and more importantly, with the confidence that they will survive this regulation to continue service to their members.

The following recaps our concerns by section of the Proposed Regulation Part 704:

704.3 Definitions

In defining "Available to cover losses that exceed retained earnings" NCUA proposes, "To the extent that any contributed capital funds are used to cover losses, the corporate credit union must not restore or replenish the affected capital accounts under any circumstances." Under this proposal, should the projected losses recognized by the corporates be greater than the actual loss, the corporate would not be able to restore the capital accounts of its members.

1. Do not require depletion and allow corporates to maintain a retained earnings deficit; or

2. Do not indicate that depleted funds may not be restored if projected losses ultimately overstate actual losses.

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704.3 Corporate Capital Requirements

The proposed regulation does not address if credit unions will be required to provide additional capital to capitalize the corporate credit unions. This has the potential to be one of the more significant effects on natural person credit unions in supporting the continued role that corporates are expected to serve under the revised regulation. Any new capital contributed by natural person credit unions should not be used to cover future losses from legacy assets.

Consider legally isolating new member-contributed capital from potential future impairment losses (i.e., OTTI) of existing non-agency RMBS (i.e., legacy assets), thereby reducing the risk weighting of the legacy assets and facilitating recapitalization efforts by the corporates.

In addition, contributed capital should not be mandated of natural person credit unions seeking corporate credit union services. Instead, pricing should be used to differentiate between members maintaining contributed core capital with the corporate and nonmembers of the corporate.

704.6 (c) & (d) Concentration limits

We use our corporate credit union as a depository for our overnight funds, to facilitate daily check, ACH, ATM/debit, and credit card clearings and to realize some earnings on those deposits. Our only real alternative to our corporate credit union has been the commercial bank account that we maintained in the past, which required prohibitive maintenance fees and/or compensating balances; using a corporate credit union for overnight deposits has proven to be much more efficient and cost effective in the management of our liquid funds.

The proposed limit on corporates to hold instruments from a single obligor to 25 percent of capital or $5 million, whichever is greater, will severely challenge a corporate to invest short-term liquidity at reasonable rates, in part because Federal Fund transactions would be restricted, and adversely impact the overnight rates we can earn; Our credit union is $450 million in assets, and $30 million is transmitted electronically to our corporate credit union each month; although we have diverted a considerable amount of our liquid funds for diversification purposes, we still have on deposit an average daily balance in excess of $26 million. There is no question in our mind that this proposal will have a negative effect on our earnings.

1. Revise Part 704.6(c) to allow a larger single obligor limit of 200% of capital on money market transaction with a term of 90 days or less; and

2. Revise Part 704.6(d) to include Federal Funds, or include Federal Funds transactions in the exception from sector concentration limits.

704.8 (c) Penalty for early withdrawals on corporate certificates

Corporate certificates offer an attractive alternative to investments in Federal agency bonds. Unlike securities, corporate credit union certificates a) are not required to be classified as hold-to-maturity, available-for-sale, or trading; b) not required to be marked to market in their accounting treatment; and c) do not require competitive bids to purchase (per NCUA Reg 703). In addition, because corporate certificates can currently be sold back at a market rate, they can be redeemed should liquidity become a concern. These characteristics have made corporate certificates an essential component of our credit union's investment portfolio and liquidity strategy.

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If the redemption value for corporate certificates is limited to 100%, they will be less attractive to credit unions that hold such investments as part of their liquidity strategy. Eliminating the ability to receive a premium on certificate redemptions will eliminate any incentive for us to continue to place longer-term funds with a corporate credit union when similar instruments offered by others do no penalize for early redemptions. The unintended consequence of this regulation would be the inability of corporate credit unions to compete in this market.

1. Remove this proposal from the final rule.

704.8 (e) & (f) NEV sensitivity analyses

The corporate credit unions have stated that when these limitations are all in place, in all likelihood they will prevent the corporate credit unions from earning sufficient interest margin to reach the capital requirements in the proposal. An unintended consequence could be that the corporate credit unions will be forced to increase their fees or otherwise reduce returns to their members to compensate for the loss of income, thus making them less competitive and a less long-term viable option for natural person credit unions.

1 Eliminate these limitations from the proposed rule.

704.8 (h) Weighted average asset life

The proposed regulation imposes a maximum two-year weighted average life for a corporate's aggregate assets and includes loans in the asset weighted average life limits. This would severely limit the corporate's non-loan securities portfolio to short, no-return assets, to save capacity for member lending. The limitations placed on asset maturities will inhibit a corporate's ability to make term loans to natural person credit unions beyond two years. Natural person credit unions will be forced to seek other sources to address their long-term liquidity needs. The restriction on the weighted average asset life to two years also means that corporates will not be able to invest in longer terms to ride the yield curve, and thus not be in a position to structure certificate offerings to its members comparable to agency investments. In the past, the corporates have worked with our credit union to structure investments specific to our needs based on the range of investments in their portfolio. The overall effect is to leave the corporate unable to offer competitive rates.

1. Lengthen the weighted average life for a corporate's aggregate assets beyond two years;

2. Adjust the weighted average life for government guaranteed securities and Agency securities to five years; and

3. Exclude loan to corporate credit union members from the weighted average calculation.

Compensation Disclosure

Disclosure of executive compensation is currently standard for publicly-traded companies, which corporate credit union are not; in addition, corporate credit unions are subject to oversight by an Agency of the Federal government, NCUA, which has the responsibility to ensure that the credit union is operating in a safe and sound manner and does not pose a risk to the National Credit Union Share Insurance Fund. We do not concur that senior executive officer and director compensation should be disclosed, simply upon member request; rather, NCUA should be tasked with reviewing the corporate credit union's compensation policies and procedures to determine if they are reasonable and appropriate under the existing circumstances.

1. Remove this proposal from the final rule.

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Vendor oversight requirements of natural person credit unions

NCUA Letter to Credit Unions 07-CU-13, Evaluating Third Party Relationships, requires credit unions to evaluate their relationships with third parties to protect their operations. Services provided by corporates to credit unions are typically essential to carry out daily credit union operations and any interruption or failure of service would have a tremendous impact on credit unions and their members.

NCUA states that under the proposed capital requirements, "only two of the 28 corporates would be considered well capitalized or adequately capitalized today, while 16 of 28...would be considered critically undercapitalized (the lowest net worth category). Only two of the corporates would meet the proposed minimum 4% leverage ratio requirements.

NCUA states, "The 18 retail corporates that have zero retained earnings will face a significant challenge in meeting the 4% leverage ratio requirement" and at the end of year six, they would have to have retained earnings of 1% of their net assets. "This will require earnings in the range of 0.15 – 0.2% of net assets, depending on asset growth. This will require adjustments to business plans and will limit the ability of these corporates to grow."

Based on these statements made by NCUA, we are concerned if corporates will be able to survive this regulation. Whether risk evaluation is conducted by independent parties or the NCUA, the process and outcomes should be made more transparent so that natural person credit unions are better able to perform the necessary due diligence to arrive at a satisfactory assessment of level of risk placed with the corporates. To facilitate this, regulatory and risk ratings should be published to provide natural person credit union with the necessary access to pertinent information.

In addition, further clarification by NCUA should be provided regarding the planned separation of "legacy assets" from the corporates. The lack of a solution to the issue of legacy assets ignores the core of the problem and thus, does not address the transition to the revised regulation nor the future of corporates with such assets on their books.

The objective of the proposed regulation should be to ensure that corporates are able to operate profitably going forward and guarantee a certain amount of stability within the corporate system through a viable business model that natural person credit unions can rely on. NCUA's proposal to tighten capital requirements and reduce risk appears to make it impossible for corporates to earn enough of a spread to be an attractive investment option for natural person credit unions. As the regulation currently stands, we are concerned that it will result in the following unintended consequences:

- Lower yields to natural person credit unions on corporate deposits
- Limited loan products at higher rates
- Increased fees associated with payment systems
- Fewer competitive short and long-term investing options

Thank you for your consideration.

Sincerely,

Gerard Auyong

Gerard Auyong
President/CEO, Hickam Federal Credit Union

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