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March 8, 2010



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

Dear Ms. Rupp:

Affinity Federal Credit Union appreciates the opportunity to provide feedback to the National Credit Union Administration (NCUA) on the proposed regulations on corporate credit unions. There are always opportunities to improve our credit union systems as the world around us continues to change. The recent world financial system collapse has, unfortunately, caused many overreactions; and the new proposed Corporate regulation is an example of such an overreaction.

Corporate Credit Unions have been the backbone successfully supporting the natural person credit union system for over 36 years. Granted the world has grown and changed dramatically over this period, especially within the financial industry, and it is obvious that credit unions need to adjust systemically to provide more capital to insure against cyclical economic disruptions as well as to fuel the growth of natural person credit unions promulgated by the passage of the Membership Access Act of 1998. Corporate Credit Unions have always been the risk aggregators for the credit union system, allowing natural person credit unions to focus on serving consumers and small businesses without the extensive and expensive infrastructure required to manage the risk inherent in these more complex operations. However, to assume that the Corporate Credit Union model has failed and now needs to be totally rebuilt with a risk adverse model is a critical flaw that threatens the foundation of the entire credit union system if the proposed new Corporate regulation is not adjusted to allow Corporate Credit Unions to compete throughout the global marketplace.

The most immediate change must be the allowance of more time to enact the necessary changes to consolidate the unnecessarily large numbers of Corporates while allowing capital to flow back into the reformed structure. It is clearly understood that the United States government, through the actions of the Federal Reserve and the Department of the Treasury, requires action to be taken to mitigate certain risks which have clearly contributed to the global financial system meltdown. Yet, it is even clearer that the Federal Reserve and the Treasury will allow the banking sector much greater time frames for this reform while it also pumps capital into the bank system. We respectfully request that the NCUA allow equal, if not greater time frames for the credit union system overhaul, since we do not have access to government funding. This would effectively mean that the new Corporate regulation should double the time frames for Corporates to comply with new net worth requirements.

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One of the areas that the new regulation should address is the number of Corporate credit unions. The current system is totally inefficient because of the redundancy of back office operations and the lack of scale needed to compete while at the same time provide the level of service credit unions are accustomed to receiving. At least one large Corporate, Members United, has proven through mergers that these levels of scale and efficiency are achievable. I believe the new Regulation should facilitate the creation of the new, consolidated business model, as this solution will best meet the needs of credit unions, while maintaining a safe and sound corporate system. The heart of the proposal, as explained in more detail further in this response and which is identical to the one proposed by Members United Corporate Federal Credit Union, is to form a new corporate that serves credit unions nationally, has a consolidated back office, has geographically distributed sales and service, focuses on payment, settlement and overnight services and seeks to reduce balance sheet footings by moving as much activity off-balance sheet as possible. This solution creates the most operationally efficient model, minimizes required capital, allows for retention of the best strategic assets in the current network and creates a new entity that credit unions will feel more comfortable capitalizing.

As I review the events of the past few years, both in my role as CEO of Affinity Federal Credit Union and Chairman of Members United, the conclusions I reach to safeguard credit unions from investment risk at Corporates differ from those in the proposed regulation. Corporates provide value in investment products in two ways 1) through economies of scale by aggregating credit union volumes and/or 2) through risk taking. In my view, creating economies of scale is required in order to remain competitive with providers from outside the credit union system. I believe the new regulation as it is currently proposed would force natural person credit unions to utilize the non-credit union providers, such as large banks, and this will, in turn, create additional risk to the credit unions' system as they actively fund a competitor who is intent on putting credit unions out of business. Corporate credit unions must take risk to offset liabilities raised as shares or certificates. These risks are credit, liquidity, interest rate, basis and cash flow volatility (e.g. prepayment.) When the corporate takes these risks, the credit union investor is shielded by the structure of the corporate. The corporate is able to develop infrastructure to better manage and assess these risks, but the business model still calls for the accumulation of these various risks at the corporate.

One of the other keys to our recommendation is to minimize balance sheet assets, thereby reducing required at-risk member capital. Again, it has already been demonstrated by Members United Corporate with the effectiveness of this strategy through their wholly owned broker-dealer, Balance Sheet Solutions LLC., which today provides credit unions investment solutions and a portfolio of balance sheet analytics and investment advisory services. Also, in partnership with other Corporates and Primary Financial, they offer insured certificates of deposits where credit unions can not only invest excess cash, but also provide a potential funding source. Both products strive to meet credit union investment needs without taking balance sheet risk or adding to required capital to support those risks. I believe other off-balance sheet products need to be developed to allow credit unions to benefit from the investment infrastructure Corporates have built and aggregation of volumes. Mutual funds or similar vehicles designed for credit unions and managed by Corporates can provide a means for credit unions to maintain a diversified risk position in investments, provide ready liquidity and still capture economies of scale from multiple credit unions. Restrictions on these underlying investments within these vehicles should be similar to those permissible in other

segments of the financial industry so that the credit union system can remain competitive without assuming the risks being underwritten by the banking community.

I believe any significant change to the cooperative credit union system and its pertinent regulations should flow from the needs of the members it serves. As a member of the Board of Director's of Members United Corporate, I have travelled throughout the Members United market footprint and have heard very clearly that members have undoubtedly stated that they want a cooperative solution available for certain wholesale services including:

- Payment processing
- Settlement
- Overnight investing
- Overnight liquidity (lending)
- Access to term investing
- Access to term borrowing

Members have further stated that they realize any cooperative solution to provide these services will need to be capitalized by them; however they are hesitant to do so in the face of future potential losses. Last, any re-capitalization by members also requires a clearly articulated value proposition showing how the new entity will add value to their credit union and its members.

The proposed changes to corporate regulations (Proposed Regulation) in my view make any existent and even a newly chartered "clean" corporate credit union (CCU) unworkable. While I agree that changes should occur in regulation, the Proposed Regulation as written does not allow for a sustainable CCU business model to meet member needs.

However, like Members United, I believe the new regulation should not be evaluated against the current CCU business models, but rather against what a new corporate system should be. As noted in the preamble to the Proposed Regulation and well documented elsewhere, the current CCU system is terribly inefficient, with significant redundancies and over-capacity. While the problems of the last three years were not caused by inefficiency, efficiency in the CCU system will be required to demonstrate value to members. Further, CCUs must commit to significant change to get credit unions comfortable with re-capitalization. Another key element is that legacy assets of the existing system will have to be isolated from the new organization and the capital members contribute to it.

Therefore, my response below outlines a vision of a better CCU system, member needs and the shortcomings we see in the Proposed Regulation vis-à-vis that proposed new model. In short, I believe a single, nationwide corporate best serves natural person credit unions (NPCUs) and their members and can meet the needs stated above at lower cost, providing better price performance and internal capital generation. However, even under this radically altered business model, there needs to be substantive changes to the Proposed Regulation to accommodate the model, the most important of which are:

- Tying the timeframes for implementation of the new capital standards to the implementation of the legacy asset plan;

- Dropping the average-life requirement while maintaining the 300 basis point credit shock test ensuring strong risk management and
- Providing credit for core deposits in the credit shock test or significantly relaxing the NEV testing requirements;

There are also several other issues and concerns including:

- Allowing for redemptions of CCU certificates to provide parity with other providers;
- Providing additional due process regarding application of arbitrary regulatory authority;
- Increasing volunteer term limits to retain qualified directors. In addition, the regulation should require nominating committees to establish more stringent director qualifications. New directors are not necessarily better directors;
- Eliminating indemnification limitations as this, when combined with other suggested corporate governance changes, makes it exceedingly difficult to find qualified, interested volunteer directors.

Additionally, while not specifically part of the Proposed Regulation, NCUA should disclose its plan for legacy assets and/or eliminate the depletion requirement, which is a non-starter for NPCU re-capitalization. The legacy asset plan is key to the industry's ability to right itself and move forward. Without that plan, it is almost impossible to adequately assess the potential impacts of the Proposed Regulation and to create a business plan for the future. Accordingly, I respectfully suggest that NCUA provide an additional comment period on the Proposed Regulation, once the plan for the legacy assets has been made public.

Members United believes the current events have created a much needed crucible for change that can make a better CCU system for members, allowing for improved efficiency and reduced risk, while still meeting NPCUs needs. However, changes need to be made to the Proposed Regulation to help facilitate this change, rather than making the CCU industry untenable.

The remainder of this paper is divided into four sections. The first section (pages 4-12) provides the proposal for a better corporate system, the second section (pages 12-15) discusses member needs and the third section (pages 16-22) provides comments on the Proposed Regulation.

A Better Corporate System

As noted above, the Proposed Regulation as currently written makes almost all existent corporate business models unsustainable. While I believe the changes suggested would improve the regulation, it will not, in my opinion, resolve the underlying problem. One of the fundamental problems in the corporate industry is overcapacity, resulting in less operational efficiency, less price efficiency and less robust products and services. While this is not the root cause of the current situation, the resolution of this problem does offer a potential solution as a new CCU system with greater efficiency can internally generate capital faster through lower costs and improved earnings, create better value for members through best of breed products and services and would be the most viable option for members to re-

capitalize. Some may note that this solution decreases competition and creates more risk by centralizing assets at the CCU level. I disagree on both counts. First, there are many other participants in the market offering similar products and services, which will continue to force market price and service discipline. This solution *would* be the only cooperative solution which relies on the participation of its members and scale to effectively compete. With regard to concentration risk, no credit union or corporate rises to the level of "too big to fail" posing systemic risk to the national financial markets. Further, as described more fully below, the new organization will be focused on payments and settlement, once again reducing systemic risk and minimizing required capital.

The Current Two-Tier CCU Delivery System

The original design of the two-tier CCU system had significant strengths that can and should translate to today's competitive environment. CCUs are relationship-driven businesses and this requires a strong local relationship presence. At the same time, CCUs operate in an industry dominated by economic scale, requiring significant volume to effectively compete on price. The two-tier CCU system provides a general framework to meet both these requirements; however, the need to capitalize each level and the operational redundancies that have been allowed to exist over the years have exceeded any scale efficiencies gained. Fragmentation of CCUs has led to an environment where no individual CCU, nor the entire industry, truly has scale as none rank in the top 30 U.S. institutions.

Given that CCUs are member-owned CUSOs, focused on a relatively narrow marketplace and have an inherent price advantage given the tax status, one would think CCUs would control dominant market share. However, today CCUs only have 27% market share of NPCU investable funds and have averaged slightly above 30% over the last several years. Other providers, who have additional scale, are able to outperform CCUs in the marketplace. This is despite advantages enjoyed by CCUs (including price performance based in part on Corporates' tax exempt status), because they have the scale to create pricing efficiency Corporates cannot. Operational efficiencies that could be gained are substantial and could translate to greater price performance for members, greater internal capital generation and a more stable CCU system. For example, total CCU operating expenses run about \$400 million per year. If elimination of redundant operations could create as little as 20% improvement system-wide, total expenses in the industry would drop by about \$80 million (about 10 basis points of total CCU earnings), or about twice the amount of *assets* of the average NPCU. While CCUs can and do add value to members, clearly CCUs' inability to truly be cooperative, in a cooperative industry, has hampered their ability to compete and, most importantly, to help NPCUs succeed.

These structural inefficiencies have been exacerbated by recent market events. CCUs operating models tend to fall into three groups today. Larger CCUs tend to house full service operations, manufacturing many of the products they sell. CCUs with a smaller asset base tend to focus on sales and acquire most, if not all, products from U.S. Central. The third model is U.S. Central, which tries to manufacture quality products for both segments as an aggregator to be a low price provider. Each of these models has come under huge pressure. U.S. Central has no member capital and cannot contemplate offering the same price performance if it hopes to rebuild capital in any meaningful manner. The downstream impact is that smaller asset-sized CCUs will lose their price competitiveness as their primary provider will not be able to provide the same pricing to them. Further, the Proposed Regulation will likely put U.S. Central in an untenable position regarding capital issuance.

Large CCUs generally have the necessary infrastructure to continue to offer products and services independent of U.S. Central; however they tend to be the weakest financially as they are still exposed to legacy assets remaining from their own investment portfolios. Smaller CCUs are stronger financially as they have absorbed all the losses they are likely to incur on their investment portfolio, making them better candidates for re-capitalization. However, without the support of U.S. Central, they lack the infrastructure to be able to offer the requisite price performance or product breadth. In short, for the vast majority of CCUs, there is no viable long-term business model today. There are some CCUs whose current financial condition may allow them to continue; however they too will face significant challenges. None of these organizations truly has effective scale levels and certainly none has, or is likely to acquire, sufficient capital to support the \$70 billion in total CCU assets. These CCUs may be able to continue to effectively serve their members, but they cannot provide a system solution for the majority of NPCUs.

To be viable in the future, CCUs will need to focus on effectiveness and efficiency. Effectiveness means doing the right things, the right way. The right thing is clear; CCUs need to add value to NPCUs, each day, each call, each visit and each transaction. The right way is via a cooperative model that delivers not only price performance, but is steeped in member focus versus profit maximization. Efficiency means doing more with less, without degrading service. CCUs cannot return to past models, practices, and approaches, because industry conditions, regulatory requirements, credit union attitudes and risk tolerances have forever shifted, which requires doing things in fundamentally new ways.

Vision of the Future

Industry Structure – There has been, and no doubt will be, significant discussion over the CCU industry structure of the future. The simple answer is that the industry needs a structure that provides the most value to NPCUs. Corporates are owned by NPCUs. They will capitalize Corporates and patronize them, or Corporates will cease to exist as they become increasingly irrelevant and subsequently no longer financially viable. The structure of the future should leverage the tremendous assets that exist within CCUs including excellent relationship management, payment systems, settlement services and effective lending products, to name a few. This coincides with the products and services that members have noted they want from CCUs as stated above. A structure that has a centralized back office to leverage scale, with geographically distributed relationship management functions, could create an efficient and effective structure for credit unions. One need only look to the Desjardins system in Canada to see a potential prototype. While the environment is slightly different, it is worth noting that the Canadian system was exposed to the same world-wide credit issues as its U.S. counterpart (CCUs), that system fared immeasurably better as losses have been comparatively nominal for our neighbors to the north.

Success Requirements – Creating a new system has tremendous potential upside for credit unions as Corporates can improve price performance, reduce costs, improve product offerings and improve service levels. However a change of this magnitude has costs and requires significant support from various stakeholders. First and foremost, all financial institutions need capital to survive and thrive. As a whole, the CCU system has a retained deficit. While some CCUs have capital, current levels for most CCUs is approaching zero. Second, it is very difficult to envision any business model that CCUs can adopt under the new regulations that will have a robust enough earnings stream to generate capital internally fast enough.

This leads to the inescapable conclusion that NPCUs will need to re-capitalize the new system at some point. There are at least three challenges to having credit unions do this. First, NPCUs are unlikely to put more capital at risk until and unless they feel the new capital is isolated from the legacy assets at CCUs. Second, NPCUs will not capitalize the new system unless there is a clearly articulated value proposition. Credit unions do have other options to CCUs; however, CCUs do bring tremendous value and in more than just price performance. For example, CCU profits are retained for the future or returned to members via product pricing, so members receive all benefits. Forcing a credit union to turn to a local bank provider often forces the credit union to subsidize their own competition and much of the value is returned to bank shareholders, not credit unions and their members. Further, it is critical that this value proposition be clearly articulated and executed as credit unions will only patronize the new organization, creating the requisite scale, to the extent that value proposition becomes reality. Third, for credit unions to risk their capital they will demand meaningful change. This means that the new organization will have to be substantively different in form, structure, leadership and geography.

Finally, there are some challenges that will have to be overcome. A more efficient CCU system means lower operating expenses in aggregate. Lower operating expenses means hard choices about products and services and the people and processes used to deliver them. To take all the existing expenses and merely combine them will not create member value and certainly not be supported by those who will ultimately capitalize the system – the NPCUs. Downsizing is painful for any organization and will be no less so for the CCU industry as a whole. However, not to do so is likely to ensure that many NPCUs will not have access to a CCU. The brunt of this impact will fall hardest on smaller NPCUs that can least afford the expertise and expense to manage products and processes offered by Corporates today.

Optimizing the Business Model for Success

Business Plan – The proposed new organization, National CFCU, would focus on several core business lines including payments, settlement, broker-dealer and other off balance sheet activities. These are all services that NPCUs want from a CCU (please see following section). It is envisioned that most term investment products would be provided through the broker-dealer and an overnight mutual fund would be developed to minimize on-balance sheet assets and, therefore, minimize NPCUs capital contributions. The broker-dealer would also continue to offer other value-added services such as balance sheet modeling and investment advisory that produce durable fee income.

The biggest challenge remains liquidity. While this model provides overnight liquidity (both assets and liabilities), it also creates more limited on-balance sheet term products, especially in regards to NPCU borrowing needs. The Proposed Regulation has several controls that will limit (and potentially, eliminate) this opportunity. While it is agreed that ultimately the term mismatch of assets and liabilities had a hand in the current situation, the unintended consequence of effectively eliminating these books of business on CCU balance sheets via the Proposed Regulation is that term liquidity will need to be supplied by other providers, primarily banks (including Federal Home Loan Banks). As competitors, banks or other financial institutions will be much less reliable sources of liquidity for NPCUs should another liquidity challenge develop, and may in some cases choose not to provide liquidity at all. I propose that National CFCU have some ability to offer term lending products. However, NPCUs that take advantage of this service will need to capitalize at a higher level, so that

National CFCU can offset the additional risk that it will need to take to offer this demanded product. The approach would be similar to that used by the Federal Home Loan Banks. Further, many NPCUs *want* access to term liquidity in case they need it; however, few credit unions *needed* these funds during the recent crisis. As a case in point, Members United never extended more than 10% of assets to members in term funding. As a result, a specific limitation was proposed in the new Regulation of 10% of assets and a higher capital level based on term dollars borrowed.

Operating Structure – As noted above, the CCU industry has tremendous strategic assets. A “hub and spoke” design that accumulates the best of breed from the CCU system in a centralized back office function and leverages the existing local sales force, with their strong local relationships, provides the best design for success based on effectiveness and efficiency. The proposed new model (the Proposed Model) would create a new CCU to more completely align existing complementary strengths. The objective of the Proposed Model is to create one retail CCU with a central headquarters and operations, but with multiple streamlined branches that are geographically dispersed. The principal advantages of the Proposed Model would be the significant increase in operating efficiency derived from eliminating redundant staff and operations, more efficient use of required capital, and the trust only found with local presence.

At the culmination of the Proposed Model, participating “cleansed” CCU credit unions (Consolidating CCUs) would consolidate into one CCU, National CFCU, with one balance sheet and one centralized back office. NCUA has announced that it is working on a legacy asset plan and this model would take advantage of that program to isolate those assets, a key requirement for future NPCU re-capitalization. Consolidating CCUs would become virtual branches of National CFCU and would convey any needed back office functions to National CFCU. Each branch would operate in its exclusive territory, its former traditional service area. In the interest of efficiency, the branding of National CFCU would replace local branding, though the local relationship management team would remain. Through the consolidation process, the NPCU members of the Consolidating CCUs would become members of the National CFCU. All CCUs will be invited to participate in this process and none will be required to participate. It is believed that the business model is viable, regardless of the number of participating CCUs, but works best with more participants. Members United CFCU currently serves almost 25% of NPCU’s nationwide and their scale and willingness to participate creates a strong foundation for the development of this concept. It is not suggested this be mandated by regulation, but considered by peers and NPCUs as an alternative to lower-value models and/or self-preservation.

To facilitate optimal service delivery as well as ensure proportional representation, regions may ultimately need to be organized by the number of, or aggregate assets of, participating credit unions. Thus, one or more Consolidating CCUs might be combined into one Region, while a large Consolidating CCU might be divided into two regions. Under the Proposed Model, a Consolidating CCU would become a decentralized front-office, handling the majority of member-facing functions. Those process elements would include sales, member support and member relations. In addition, each Consolidating CCU would be responsible for raising capital for National CFCU from the members in its respective region.

Meanwhile, the centralized back office would provide all operations and support services to the Consolidating CCUs. The back office function would be exclusively devoted to: (a)

delivering aggregated payment and settlement processing (ACH, automated settlement, wires, electronic bill payment, etc.); (b) providing asset-liability management functions and supporting overnight lending products (as supported by additional capital); (c) providing custody and safekeeping services; (d) providing support functions (accounting; credit and market risk; internal audit; human resources; legal and compliance); and (e) coordinating the activities of the Consolidating CCUs and providing consolidated and uniform reporting. In addition, the entire business would be tied together by a single, data processing system that includes a robust, secure front-end system for delivering products electronically. Moreover, National CFCU could use currently available technology to operate a "virtual call center" with member service representatives dispersed geographically, potentially at various Consolidating CCU sites. It is envisioned that in the formation of National CFCU, a suitable site would be selected that had the best potential labor pool and resources for the processes to be managed there. As Consolidating CCUs joined into National CFCU, a determination would be made as to how to move the strategic assets to be retained to the central location.

Governance Structure – National CFCU will be a large, complex, geographically-disbursed organization with complex business processes and operations. As a national cooperative serving a large and diverse credit union constituency, it will need a governance structure that can meet the diverse needs of its members, while simultaneously managing this large, complex organization.

Board of Directors. Given its structure, National CFCU's Board of Directors would have both significant responsibilities and risk. To be successful, any organization needs knowledgeable, engaged, time-committed board members. Directors should be selected on their ability and willingness to serve and this should not be a function of geography. At the same time, the perception of local representation is important to NPCUs. Their experience with mergers across geography indicates that local representation is initially important to members, though this quickly fades. In terms of board function, geography becomes irrelevant quickly as board members understand they represent all members, regardless of location or past affiliations.

Two processes will be used to address this issue. First, the Board Nominating Committee would be composed of NPCU representatives selected from each region. This would ensure a degree of local representation and would also ensure that all geographies are considered when nominating board members. A strong nomination process will be critical to the board's success. It should consider a variety of issues, including ensuring there is adequate diversity on the board (geography, member asset size, gender, ethnicity, etc.) and expertise (legal, operations, finance, etc.). A similar process would be used for the Supervisory Committee. The process would specifically exclude individuals from being a current board member to, once again, encourage diverse representation. The second process will be to form an Advisory Board for each Region. The local Advisory Boards would meet quarterly and discuss issues with the local Regional President. The Chairs of these boards would attend National CFCU Board meetings quarterly and provide reports, but would not be voting members of the National CFCU Board. This would ensure adequate linkage to the regions. The new Board would also employ industry best practices in training, education, self-assessment, etc. To allow for reasonable turnover and while maintaining continuity, the term limit section of the Proposed Regulation needs to be increased from six to a minimum of nine and preferably twelve years.

The Board of Directors would oversee National CFCU as a collective enterprise, by: (a) setting standards for both regional and central operations; (b) creating a consolidated budget with overall and regional goals and objectives (financial and otherwise); (c) adopting an overall strategic plan and comprehensive operating policies; and (d) ensuring the safety and soundness of the collective enterprise. The Board of Directors would implement its oversight through a Managing Director.

Managing Director. National CFCU's Managing Director would report exclusively to the Board of Directors. The Managing Director's principal day-to-day responsibilities would be focused on overseeing central, back-office operations. In addition, the Managing Director would coordinate business activity among Regional Directors and their respective Regions and would coordinate and assure consistent reporting of Regional CCU operations and results to the Board of Directors. The Managing Director would be accountable to the Board of Directors to work harmoniously with the Regional Directors to ensure the institution's collective success. The Managing Director would be selected by the National CFCU Board and he or she would not be a member of the Board.

Regional Directors. The Regional Directors would report to the Managing Director, and would be accountable for the performance of his or her respective Consolidating CCU. As such, each Regional Director would be responsible for meeting standardized and individualized performance targets. Regional Directors would operate with autonomy regarding local member support and relationship management efforts, consistent with the national branding campaign. The structure would be similar to a franchise.

Benefits to Participating NPCUs and Consolidating CCUs

Placing paramount emphasis on the interests of NPCUs, the Proposed Model would provide the products and services that NPCUs need with the local presence they desire, but with a significant increase in operating efficiency derived from eliminating redundant staff and operations, as well as more efficient use of capital. The Proposed Model recognizes the significant value to NPCUs in the CCU system, and preserves that value in the future. Meanwhile, the Proposed Model restructures the constituent components of the CCU system in such a way that it operates with a significantly increased assurance of safety and soundness, capital adequacy, and effective risk management. For Consolidating CCUs, the Proposed Model would end the focus on CCU competition and focus on value for NPCUs. The Proposed Model would install a governance structure that eliminates the perceived self-interest of the past. The Proposed Model would comply with newer, more stringent regulatory capital and governance requirements, thereby assuring future capital adequacy. The Proposed Model would have strong, independent risk monitoring and management, as well as internal audit, compliance, and early warning features and functions. The goal of the Proposed Model is to create value for NPCUs. Creation of a CCU structure that a meaningful number of NPCUs will capitalize and use will be evidence of the success of the model. To be effective, and to be put into effect, the Proposed Model would need to be presented to NPCUs in the form of a business plan in which they see sufficient value to provide capital, which in turn describes a structure that they will perceive as sufficiently safe and isolated from the current legacy assets.

Benefits to the Credit Union System and the NCUA/NCUSIF

There are several key stakeholders in this process, including the regulator and the insurance fund that continue to provide stability to the market during this time. The lowest cost

resolution for the NCUSIF would be for National CFCU to retain participating CCUs' legacy investment assets, supported by an NCUSIF "wrap" or asset guarantee. This would permit National CFCU to obtain NPCU deposits, historically a CCU's cheapest source of funding. This approach could potentially contain the amount of share insurance premiums that all federally-insured credit unions might bear. This will also tie the legacy assets back to the credit unions investing in the CCU system so that if at some point in the future the losses are less than projected, the investing NPCU's will reap the benefits.

The Proposed Model would also further the rationalization of the CCU system with: (a) the elimination of the wholesale tier and associated layered balance sheets; (b) the reduction in the number of CCUs and the costs associated with duplicative and redundant operations; (c) a surviving National CFCU that operates more efficiently and safely and that, ultimately, would be better capitalized. In addition, the NCUA would be assured of more effective supervision and oversight of a major provider of products and services to NPCUs than it would have if those products and services were delivered by institutions and vendors outside the credit union system.

Transformation and Transition

The transformation from the current CCU business models to the Proposed Model cannot occur overnight. Rather, practical considerations of combining operations, governance, stakeholder acceptance and approval, financial considerations, as well as legal, regulatory, and accounting issues, all dictate a carefully planned and phased transition. This transition will require 24 months or more to execute. Set forth below is a high-level description of potential phases that might be required.

- **Phase 1** – Consolidating CCUs would execute an "isolation strategy" to insulate the new structure and new investors from risk of loss associated with its current portfolio of impaired investment assets (legacy assets). NCUA has announced that they are working on a legacy asset strategy and this strategy is required for success of the new venture as it will insulate members that wish to capitalize the new organization from losses on those legacy assets. The goal of such an isolation strategy would be, in effect, to isolate the CCUs' legacy assets and to "push out" CCUs' non-"at risk" assets and its critical back-office operations and functions into a newly-formed charter – the initial backbone of National CFCU. Implementing a successful isolation strategy could take up to six months.
- **Phase 2** – The governance of National CFCU will need to be established and begin functioning. The Board will need to be seated and will need to select an initial Managing Director, develop its governance processes and charge the Managing Director with developing a plan of consolidation. The Managing Director will need to acquire the necessary staff and other resources to develop a viable transition plan; combining such a potentially large number of CCUs has immense transaction risk and given that there is no capital to absorb losses from consolidation problems, the plan must be carefully thought-out and managed. A location for National CFCU will need to be established. The Managing Director will then need to work with interested Consolidating CCUs to determine which strategic assets will be moved to the new organization from the existing CCUs that wish to participate. The Board of National CFCU will act as the Steering Committee for this process and, working with the existing Consolidating CCU Board, will be the final arbiter. Another key deliverable

of this phase will be the business plan that will clearly articulate the value proposition for NPCUs, which will ultimately be the driving force behind future capitalization by NPCUs. This phase will require some seed capital, which will be contributed either from the Consolidating CCUs remaining member capital or from new NPCU members.

- **Phase 3** – In a series of transactions, National CFCU would consolidate – one-by-one – with all CCUs that wish to participate. Participation will be offered to all and required of none. The order of consolidations would be determined solely by the ultimate best interests of participating NPCUs. The process of consolidation will be driven on how to most quickly and effectively integrate the best-of-breed products and services. Ultimately National CFCU's ability to offer quality products and services will determine its viability and success, therefore integrating these delivery platforms and associated infrastructure will be the priority. The duration of this consolidation process would be wholly dependent on, and determined by, the number of Consolidating CCUs, which CCUs they were, and the complexity associated with the particularities of consolidating that CCU.

Member Needs

Since the beginning of this financial and capital market crisis, Members United has striven to provide maximum visibility to their member/owners relating to market conditions, their holdings and expected and potential developments. They also have been able to gather a great deal of information from members as to what credit unions need and want from a corporate. This information comes from multiple sources including direct contact with their member-facing staff, town hall meetings, member correspondence and member surveys. These surveys break down responses by both question and member asset size. Through the surveys and member contact, it was found that perspectives on corporates are often affected by credit union asset size and their level of operational complexity. A few key themes recur in their continuing dialogues:

- Corporates provide valuable payment and settlement products and services;
- Corporates provide valuable liquidity resources both short term and long term;
- Corporates provide beneficial investment alternatives for excess liquidity;

Each of these issues will be explored in turn.

Payment and Settlement Products/Services

There is a dichotomy of opinion on the value corporates provide in this area, based primarily on NPCU asset size. For most small- to mid-sized credit unions, the value is recognized and acknowledged. However, many large credit unions feel they do not need a corporate for access to these products and services. In point of fact, large credit unions certainly have a much wider range of alternatives for payment product providers. Closer review of the detailed implications of a full conversion from corporate payment products for large credit unions indicate they have underestimated the value corporates provide in this arena. While larger credit unions often have volumes that might allow them to negotiate pricing equivalent

to corporates, there are many non-price related aspects to the migration to new vendors. In reviewing these issues with large credit unions, it was found that the following points of value that are created by CCUs are often not well understood:

- CCUs are a valuable provider of liquidity, and in some cases, may be the only viable lender at a reasonable cost. CCUs establish easy-to-access, readily available lines of credit, without onerous collateral or debt covenant terms. Additionally, relying on a potential competitor, when you most need liquidity, increases risk substantially.
- CCUs have specialized staff that may not be economically-justified for individual NPCUs. For example, CCUs retain payment specialist who work with the Fed and other counter-parties daily to manage adjustments, settlement account balances, etc. In many cases, NPCUs will either not be able to afford this expertise or will have to acquire it, undoubtedly at a higher cost as that individual CCU bears the entire cost of that resource.
- CCUs have invested heavily in infrastructure in terms of secure access, systems, people and processes to ensure that transaction processing is effective, efficient and secure, in most cases at minimal costs. Often other providers have substantial fees for providing this same level of secure access.
- CCUs are a cooperative founded for their members and reflect the same values and the same member-service focus. CCU staff is dedicated to service at a level that is not found in most other vendors.
- While many options exist in the marketplace, CCUs process hundreds of billions of payments annually, hundreds of trillions of dollars of wires and investments and thousands of member visits annually, allowing them to truly understand their members' needs. Switching transaction processing for these substantial volumes is not an inconsequential task and involves, detailed planning, cost and risk.
- Corporates provide aggregation, economies of scale and operational efficiency. In addition, CCUs provide extensive follow-up and support which are vital services that are not often found to the same extent at alternative vendors. While many of these activities can be replicated at large credit unions, it requires additional management focus, and development of procedures and backups. Also, inevitably, there is operational risk associated with switching vendors for these critical products and services, which could have significant potential impact on their natural person members. Some large credit unions are convinced they could easily migrate products, but then reassess their opinion once the scope and impacts of migration are fully understood.
- Corporates also provide robust, easy-to-use settlement services that are much demanded by members as a critical operational need.

Liquidity Products/Services

Credit union perspectives related to liquidity and lines of credit provided by corporates seem to be much more unified across credit unions regardless of asset size. This is likely because the ability to obtain credit lines from most banks has disappeared over the last three years. Banks unwillingness to lend, due to an extreme reduction in appetite for additional risk, made securing new lines almost impossible and, when possible, usually prohibitively expensive. Some member credit unions were denied lines of credit for liquidity from local banks because they were considered competition. Even if local or other banks were to approve these

liquidity lines, would these lines be available when needed? In addition to lines of credit, CCUs also provide other support for credit union liquidity. These additional services include assistance with developing alternative liquidity vehicles like issuance of insured certificates of deposit through Simpli-CD. CCUs also work with member credit unions to explore options related to loan sales and participations, and securitized borrowings.

The Federal Home Loan Bank system (FHLB) is generally the first source of liquidity, next to CCUs, especially in relation to term borrowings. The FHLB leverages its position as a government agency to secure inexpensive funding, which provides some benefit to borrowing members in the form of slightly more favorable rates. However FHLB borrowings are also not without challenges. Capital stock needs to be purchased and must represent at least 5% of outstanding borrowings (FHLB, Chicago.) While some of the forms of capital used by FHLB can be redeemed when borrowings mature, the financial conditions at most FHLBs currently prohibit such redemptions. To date, FHLBs have not yet had to force a write-down of capital stock due to interpretation of their regulation; however, the possibility exists for significant future write-down of capital at FHLBs.

While many credit unions express the need for term borrowing capability from CCUs, or other sources, few actually utilize it. Many times this is related to the increased costs of term borrowings in positively sloped yield curves. Additionally, NPCUs also assess the cost of raising similar deposits from the natural person member base. Other considerations that often discourage term borrowings include potential dilution of capital ratios, strong share growth or weak loan growth trends.

Notwithstanding the liquidity support that Corporates provide related to settlement and short-term investment and borrowing products, liquidity needs are broadly recognized as important and necessary. Similarly, the NCUA proposed regulation also recognizes its importance in highlighting the need for sufficient funds to support settlement activity.

Investment Products/Services

Credit unions have traditionally relied on CCUs as a storehouse for excess liquidity. For the most part this was kept in overnight accounts at CCUs. Excess liquidity might also be invested in term certificates to take advantage of rates when the yield curve was positively shaped or to leverage excess liquidity beyond what was necessary for short-term operations. Though different credit unions had different liquidity requirements, the history of balances in these accounts showed definitive monthly, annual and cyclical trends. Given the stability of these deposits, CCUs began to invest in term instruments, often time floating-rate investments, to provide higher yield to members as well as to support capital and infrastructure growth. This proved a stable and safe investment alternative for credit unions for many years. Today, credit unions still utilize corporate overnight accounts primarily for their short-term liquidity, in no small part due to the deposit guarantee implemented by NCUA.

Term certificates are also a popular investment alternative with members. They provide competitive yields, liquidity (as collateral for borrowings from the corporate) and convenience. Corporates re-invest proceeds primarily in capital market instruments taking limited and controlled amounts of risk. Even so, market share of CCUs as a percentage of

total NPCU investments had fallen to 20-30% for most Corporates. Thus reliance on corporates for investments was certainly not complete. As Corporates started to experience losses from the decline of previously-rated "AAA" and "AA" securities, confidence in corporates began to deteriorate.

Credit unions continue to see a need for CCU investment products. A majority of members still see a need for Corporates to offer both overnight and term deposit products. In a recent survey, about 25% of respondents felt Corporates should only offer short-term investment products and alternative investments for longer term investments. Thus, by inference, almost 75% of respondents look to Corporates for longer-term investments. One consideration often overlooked is that without a significant term certificate or term borrowing capacity, Corporates cannot reasonably provide significant term liquidity to their members. Members input to date highlights liquidity as a key concern or issue that they count on Corporates to supply.

Other Considerations

NPCUs will continue to experience depletions to their capital accounts at CCUs with upcoming rounds of year-end 2009 OTTI charges. For Corporates to continue to provide either overnight or term investment products, recapitalization of Corporates is necessary. In a Members United survey, respondents indicate the need for stronger capital positions at Corporates in the future. However, credit unions are concerned that further capital contributions might be subject to further depletion. Clearly credit unions need to know that their capital investment in Corporates will be safe from continuing losses before further investment in Corporates will be considered. In this same vein, there are three recurring comments from credit union members willing to even consider further capital investments in Corporates:

1. Further capital contributions must be insulated from further losses from legacy assets on the books of Corporates today;
2. Corporates must be able to clearly demonstrate the value of membership in terms of available products and services;
3. Corporates must pay a fair return for "at risk" capital to support continued operations.

In many respects the Proposed Regulation looks to ensure Corporates cannot incur losses from their investment activities. As the business model in the regulation section demonstrates, no risk equates to no return. It is believed the answer to this conundrum rests not in developing significantly wider risk tolerances or reduced capital requirements. There needs to be a paradigm shift to meeting credit union investment needs with innovative solutions, like those provided by Members United's broker-dealer Balance Sheet Solutions, by the corporate network owned Primary Financial's Simpli-CD program and most fundamentally via a new corporate business model as described above. These programs currently meet credit union investment and payment needs without the aggregation of risk inherent in on-balance sheet products like overnight and term certificates.

Review of the Proposed Regulation

The new Regulation has been evaluated in light of the proposed new CCU model and many of the key tenants are agreed with in the proposed regulation; however, there are several parts of the Proposed Regulation that need to be changed for the new model to be workable.

NCUA Business Model

The proposed regulation provides a business model that demonstrates how a CCU's balance sheet and income statement could be managed to meet regulatory risk requirements as well as generate sufficient income to meet ongoing capital goals. There are certain modifications necessary to the model used to properly capture market spreads and balance sheet components. Below is a recreation of the regulatory model with appropriate adjustments:

Category	Percent	Total	Spread	Revised Spread
Assets				
FFELP Student Loan ABS	20%	1.00	0.25%	0.25%
Private Student Loan ABS	10%	0.50	2.00%	0.30%
Auto ABS	20%	0.60	0.25%	0.25%
Credit Card ABS	10%	1.00	0.30%	0.30%
Other ABS	10%	0.30	0.10%	0.10%
Overnight Investments	30%	0.00	0.00%	0.00%
Asset Subtotal	100%	0.501	0.34%	0.17%
Liabilities and Capital				
Overnight Shares	30%	0.00	0.00%	0.00%
Term Certificates	66%	0.50	0.00%	0.00%
Capital	4%	0.00	0.00%	3.00%
Liabilities and Capital Subtotal	100%	1.53	0.00%	0.19%
Net Spread			0.34%	-0.02%

The changes to the model cover three main areas:

1. Spreads on private student loan ABS are overstated. This sector of the student loan market has very limited issuance potential. Additionally, the ability for corporates to be able to find and purchase investments at these spreads is unlikely. Market clearing spreads are closer to 30 basis points; with adjustments in the model having been made. As can be seen above, this single correction reduces profitability from 0.34% to 0.17%. This also highlights the risk of using a single asset class that generates an inordinate share of interest income. Another consideration is that for an asset class to pay almost 10 times the spread of similar asset classes, the market must be assuming some significant level of risk that is not reflected in ratings. Outlook for most student loan performance by rating agencies are, at best, negative to stable.
2. On the liability and capital section, there are two changes. The first is the addition of a capital component. It has been made very clear that contributed capital requires a

fair return for the risk taken. With no definitive solution to legacy assets on corporate balance sheets, it is difficult to assess what return credit unions would require for a capital investment. However, a proxy from the banking industry provides some basis for comparison. JP Morgan recently issued a preferred stock instrument which will yield just over 7% for the first 4 years and convert to 3-month Libor plus 446 basis points. Thus, a proxy of plus 300 basis points is appropriate for calculation purposes.

3. Certificate spreads are expected to be closer to Libor plus 10 basis points. This is a reflection of current markets and future expectations. Another part of the proposed regulation imposes limits on paying premiums on certificate redemptions, which will increase the yield credit unions will require to invest in certificates.

The net result of the adjustments is that the model cannot generate sufficient yield to support growth targets for capital over time. Given the adjustments required, capital would be *eroded* at two basis points per year (i.e., negative net income on a perpetual basis). Therefore, two changes to the Proposed Regulation are recommended: 1) increase the timeframes for implementation of the new capital standards and, 2) relax or eliminate certain risk parameters. Alternatively, a combination of both could be considered. Several other, more technical, changes to the Proposed Regulation are also suggested later in this section.

Capital Standards

The new regulation contains three new definitions of capital: leverage, Tier 1 risk-based and total risk-based. I support the Proposed Regulation's new definitions of capital and agree that a new set of capital standards are required; however, the timeframes for implementation of these new standards, especially given the lack of clarity regarding the legacy asset plan, makes them untenable. As noted above, members have clearly communicated their unwillingness to supply more capital unless losses from legacy assets are isolated. Further, given the extremely limited risk tolerances provided (see below), meeting the capital ratios through earnings will be exceedingly difficult. The ability to build a new, profitable business model will also be highly dependent on how the legacy assets are handled, as this can have a critical impact on future earnings streams. Therefore, it is recommended that timeframes for compliance with the capital ratios be tied not to the date of the publication of the Proposed Regulation, but rather to the final implementation of the legacy asset plan.

Risk Limits

Based on numerous analyses, CCUs cannot meet both the proposed capital and risk metrics, even with no legacy assets on their books.

I strongly recommend that NCUA, at a minimum, make the following key changes:

- Drop the average-life requirement while maintaining the 300 basis point credit shock test ensuring strong risk management *and*;
- Provide credit for core deposits in the credit shock test or significantly relax the NEV testing requirements. This is an important change to accurately assess risk in this stressed scenario.

Both changes are needed and doing any less jeopardizes the viability of the CCU system for both existing and any new CCU business model. Ultimately, the operating environment of

many in the CCU system could be severely impacted as Corporates would need to be replaced, which would force greater costs onto NPCUs, with a disproportionate impact on smaller NPCUs.

Drop the Average Life Requirement – One key area is the proposed limitation on the average life of assets (investments and loans) to two years. The Proposed Regulation uses the two-year limit as a means to control credit-spread risk in asset portfolios. This objective is important because even though CCUs did not take interest-rate risk, as they tended to purchase floating-rate assets, these assets were sensitive to changes in credit spreads. However, the Proposed Regulation already features a mechanism to manage credit-spread risk. Credit-spread risk is managed by limiting NEV sensitivity in a credit-spread-widening environment. This approach also involves a shock to prepayments, effectively preventing Corporates from taking excessive credit-spread risk. Therefore, it is recommended that the new regulation drop the average life limit. Additionally, the limit would also be sensitive to the level of cash balances a corporate may be carrying. As seasonal trends change, the cash balances may temporarily fall. This effect could cause a temporary violation of the average life limit. Unchanged, what this means to credit unions is that corporate portfolios will become shorter in duration. In turn, Corporates will be much less likely to make term loans and spreads will decline, which in turn will force Corporates to reduce rates substantially.

Provide Credit for Core Deposits in the Credit Spread Shock Test – NCUA is encouraged to integrate core deposit assumptions on overnight accounts into the credit spread test. While CCUs are wholesalers and their deposit base behaves differently than that of NPCUs (per NCUA's comments), overnight deposit accounts related to core correspondent settlement activity and credit union liquidity needs, are relatively stable over time. Taken together, these two important changes would still maintain the integrity of stronger risk controls, but allow for CCUs to take measured levels of credit risk to be able to pay reasonable rates and earn the required levels of income to meet the capital requirements.

Other Issues/Comments

Certificate Redemption – The Proposed Regulation prevents redeeming certificates at a premium. Understanding that the intent is to protect liquidity; this regulation, however, will have a significant negative effect in the marketplace. Corporate certificates will *de facto* be less liquid than other providers. Unless yield is adjusted (i.e. CCUs pay more), members will take their business elsewhere. What this means to credit unions is that corporate certificates will be inferior to other certificate offerings, unless there is a substantial price differential, which Corporates are unlikely to be able to afford. A conservative estimate of the required yield differential because of this feature could cost Members United an additional 10 basis points or \$2.5-\$3 million a year on term deposits. This would essentially weaken certificates offered to members, increase costs, and hamper liquidity. While it is anticipated that CCU balance sheets will house less on-balance sheet term certificates in the future as CCUs look to move these funds off-balance sheet, there will need to be some on-balance term product to allow CCUs to offer some term lending product, a key demand of members. Without some ability to offer term investment products, CCUs will not be able to offer term lending to any members, without taking on significant interest rate risk. Corporate term lending is an important part of some credit unions asset/liability management program, allowing them to utilize a ready source of long-term liabilities that they may not be able to replicate with

member deposits. Therefore, this change is critical to allow CCUs to meet their members' liquidity needs.

Regulatory Authority – It is critical that the regulator has sufficient authority to manage, supervise and control corporate credit unions. However, the Proposed Regulation vests an untenable level of regulatory control with little oversight, no required documentation, and no objective appeal process. Observations include:

- NCUA has the ability to subjectively change minimum capital requirements for any reason or no reason.
- NCUA has the ability to subjectively change the application of rules and regulations without appropriate due process. Should changes in application of the regulations be necessary, due to new financial instruments or strategies, the NCUA Board should make amendments to the regulation through the current regulatory approval process.

At a minimum, NCUA board approval should be required to approve changes in capital level requirements or regulatory ratings at CCUs. Both the reduction of the capital rating and the basis for the reduction (declines in a single CRIS-rating category) are subjective decisions made by NCUA. The NCUA already has sufficient regulatory tools to enforce compliance with safe and sound operating practices, without this complex and, what could conceivably become, arbitrary process. It is recommended that an appeal mechanism be developed to support an objective process. Further, it is proposed that the authority to exercise these regulatory prerogatives be tightened significantly. Also recommended is that the NCUA Board approve any such change in capital requirement only with: a) appropriate documentation of risk, and b) the opportunity for the corporate to offer explanatory evidence.

Required Depletion from OTTI Estimates – Significant accounting research has been done on the issue of depleting member capital on the basis of a CCU carrying a retained deficit, primarily due to booking OTTI estimates. GAAP does not require depletion of member capital accounts, although it is in NCUA's purview to require depletion under current law. NCUA is encouraged to utilize the guidance of GAAP and not require depletion of members' capital shares to clear retained deficits resulting from OTTI estimates as well as disclose its legacy asset strategy. This approach will give members the comfort they need to be willing to invest additional capital in CCUs.

Governance and Board Limits – It is agreed that it is critical to maintain qualified representation from members on the Board of Directors. It is further agreed that there is a rationale for term limits. However, term limits do not ensure a well-qualified and diverse board – it only ensures that there will be a new Board.

It is more important to charge a Corporates nominating committee with the responsibility for establishing detailed criteria for the expertise of Board members. Under the proposal, it is possible for a corporate Board to be made up of credit unions with the same asset size or of like mind and similar talents. An ideal Board would be composed of diverse individuals possessing complementary talents.

To allow for better representation, nominating committees should be required to define the qualifications of ideal or targeted candidates. For example, Board qualifications could include:

- A specialization in finance, accounting, marketing or operations, and
- Leadership from an array of credit union asset sizes, and
- A representative distribution across geographic regions, and
- A desire to promote the good and welfare of the organization

Corporates should also require that Boards and Board members adopt best practices related to attendance, training, self assessment and other board processes. There is a concern that the current six-year term limit, as proposed, will require the entire Board to turn over every six years. While term limits are appropriate, a rapid turnover of volunteers who direct and oversee the operations of financial institutions like Corporates would be detrimental. Term limits this short will only guarantee the loss of institutional intelligence. Having a six-year term limit would produce an average service of three years or less (if unanticipated turnover takes place). This would occur if a director lost his or her qualifications to sit on the Board, or circumstances otherwise necessitated an unplanned resignation. A new Board member would not be able to gain the wider breadth of experience that a current Board member would possess if they had experienced several business cycles at the corporate. Additionally, a knowledge "ramp-up" for most Board and committee members occurs as they develop a more detailed understanding of the business processes and strategies applied by the corporate. This knowledge base and experience is fundamentally different than those developed by credit union management that works with the Boards of natural person credit unions. term limits should be expanded to nine to twelve years, from the proposed six-year timeframe. Board membership would still benefit from "new blood" while maintaining the organizational history of the corporate. An unstable or inexperienced Board poses a safety-and-soundness concern for the regulator.

Indemnification – The Proposed Regulation prevents indemnification in some cases. While it is understood that the intent is to prevent indemnification against regulatory actions, the language is fairly broad and exposes volunteer directors and management to unlimited personal risk. This means it may be difficult to find and retain volunteers and management. Quality leadership will be critical in the future and this may cause many capable leaders not to participate.

Interest Rate Swaps – Most interest rate swap counterparties maintain Credit Support Agreements (CSAs) that require collateralization of positions or exposures. The proposed regulation does not recognize the impact of these collateral deposits in assessing credit exposures. A risk based computation is recommended should net collateralization in the calculation of risk based exposure.

Limits Based on Capital (Investment and Borrowing) – Overall limits on obligor and sectors (investments) based on capital are generally appropriate and reasonable. However, in a time when most Corporates face depleted capital levels from OTTI charges and U.S. Central capital write-downs, this may cause investment and borrowing limits to be overly restrictive. Additionally, borrowing limits based on diminished capital levels could create

severe liquidity issues during times of low credit union liquidity. These limits should be phased in over time in line with capital requirements.

Liquidity limits – The limits as proposed are not supportive of potential liquidity situations. A limit of 30 days for secured liquidity borrowings may easily aggravate liquidity situations by not allowing access to term liquidity. This would force Corporates to only rely on short term liquidity alternatives which could be closed or reduced, thereby increasing systemic risk. In addition, the limit on borrowings of 10 times capital or 50% of capital and shares is too restrictive. With many Corporates in the process of re-building capital, this will overly restrict use of liquidity alternatives, increasing the potential for a serious network liquidity event. It is recommended that current limits are maintained.

Prompt Corrective Action – While restricting dividend rates to “the region the institution is located” may be an effective control for natural person credit unions, it is not applicable to corporate credit unions and may have unintended consequences in the form of either uncompetitive rates or increased costs when applied to large areas of geography. In addition, it is important for NCUA to be able to maintain qualified staff at Corporates under PCA. However, as currently written (“...dismiss from office any director or senior executive officer who has held office for more than 180 days immediately before the corporate became undercapitalized.”), the regulation grants authority to dismiss based simply on term of service.

It is recommended that the restriction on dividend rates should be dropped, and that while the NCUA should have discretion to ensure qualified staff at Corporates under PCA, mandatory dismissal based upon on term of service is not supported.

Senior Management Compensation Disclosures – While this is often required in for profit and public companies, it has never been a requirement of either natural person credit unions or corporate credit unions. Public companies have additional ways to compensate management that justify additional disclosure, and often senior management compensation is either a material transaction or has significant change of control provisions, neither of which exist in the CCU industry. In addition, the definition of “senior officer” in the Proposed Regulation is overly broad and would go down to a broad spectrum of corporate credit union managers.

These proposed changes may make it difficult to attract and retain qualified staff, especially at critical and technical positions within the corporate, and thus defeat the purpose of ensuring safe and sound operations. Corporate compensation disclosures should follow natural person disclosure requirements. Also, if compensation disclosure is required, the definition should be narrowed to CEOs and their direct reports only. This aligns more closely with bank definitions of “executive officer”.

Prepayment Speed Tests – A slowdown of 50% may be appropriate for mortgage related securities, but is grossly exaggerated for other asset classes.

Suggested changes include:

- a. Differentiate with appropriate shock test by asset class as follows:
 - Agency MBS

- Private MBS
 - Non-agency ABS
 - Auto
 - Credit Card
 - Student loan
 - Other
- b. Separate from Credit Spread Test

Conclusions

I strongly believe that Corporates can provide valuable products and services. I recognize that the viability of any corporate, regardless of form or structure, will be at the behest and will of its members. The business model and regulation changes introduced and advocated by myself, Affinity Federal Credit Union and Members United can help credit unions succeed, while meeting most of the goals of the many and varied stakeholders of the credit union and corporate network. I stand ready to address questions regarding this vision and perspective and thank the NCUA Board for their diligence, hard work and proactive responses during what may be considered, in retrospect, one of the most difficult times in credit union history.

Thank you in advance for consideration of these changes.

Sincerely,

Affinity Federal Credit Union



John T. Fenton
President and Chief Executive Officer