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MARK G. HOLBROOK
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March 8, 2010

SENT VIA FAX #703.518.6319

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

Re: Proposed Regulation 12 CFR Part 704

Dear Ms. Rupp:

We 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.

We want to thank NCUA for its deliberate approach in this very important rulemaking. We recognize that the NCUA Board and staff have spent an enormous amount of time and effort in researching, discussing, soliciting and evaluating input in the creation of 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, we regret to state that in our view the proposal raises 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. If not amended, these parts of the proposed rule will force my credit union into the undesirable position of seeking alternative, possibly far more costly, and certainly more unreliable, providers.

Further, several of these provisions will have harmful effects on natural person credit unions and, ultimately, their members. Many of these institutions are small credit unions that depend upon the services offered by the corporate system for their survival.

The critical issues outlined below include:

1. Legacy Assets in Corporate Credit Unions
2. Retained Earnings Growth Model

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3. Time Period for Capital Ratio Attainment
4. Weighted Average Asset Life
5. Penalty for Early Withdrawals on Corporate Certificates
6. NEV Sensitivity Analyses

We are deeply concerned that if the following issues are left unchanged, there will be severe repercussions to corporate credit unions, which in turn would have harmful effects on credit unions that rely on them.

Critical Issue #1 - Legacy Assets in Corporate Credit Unions

The Proposed Regulation in its current form does not address the issue of the legacy assets that are creating the instability in the network as a whole, but it should. Investment securities remaining on corporates' books continue to create instability in the network, and serve as a major disincentive to credit unions providing any future capital contributions.

We strongly urge NCUA to cooperatively and transparently address the business and regulatory issues associated with these assets. We believe that failure to do so 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.

Critical Issue #2 – Retained Earnings Growth Model

We are of the opinion that 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) do not represent a reasonable or attainable mix. 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. We believe this violates principles of concentration risk, represents too much exposure, and is not indicative of attainable real-world results.

There are also issues with the funding mix suggested by NCUA's example that would impact earnings. Using 66% of funding in the form of certificates when the proposal seeks to abolish the payment of premiums on early withdrawals (see critical issue # 5) will dramatically change the funding mix. Adoption of that proposed rule change will surely reduce the amount and term of certificates that will be issued. And any change in the funding mix with lower volume and/or shorter average lives will cause the volatility limits to be exceeded by even greater amounts.

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Critical Issue #3 – Time Period for Capital Ratio Attainment

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 critical issue #2 above), 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. Given the perceived lack of a viable business model, why would member credit unions choose to make such an investment?

Critical Issue #4 – Weighted Average Asset Life

We look to WesCorp as a liquidity provider for both short- and long-term needs. We understand that the limitations placed on asset maturities or average life limitations may severely impact our ability to obtain term liquidity if we need it.

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. The two year proposed limitation will force many credit unions to seek less beneficial, or more expensive, funding from other sources. Therefore, we request the Board to 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. In addition, loans to member credit union have proven to be the best investments corporates have made resulting in minimal or no losses.

Critical Issue #5 – Penalty for Early Withdrawals on Corporate Certificates

Currently, a corporate may adopt a policy to redeem an outstanding certificate at a market rate, even if it is at a premium dollar price. The proposed regulation eliminates this ability.

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This will place corporate credit unions at a significant funding disadvantage and will likely destroy or make non-economical, the institutional funding market for term certificates. This change will also have negative implications on system liquidity, corporates ability to achieve a sound funding strategy, and may impact the ability of corporates to provide lines of credit to credit unions.

Corporate term certificates are in direct competition with Agency issued debt. Corporates have been able to compete effectively based on yield (paying competitive interest rates), flexibility (structuring terms that meet credit union needs rather than credit unions having to take whatever the Agency market happens to be offering), collateral value (assigning 100 cents on the dollar on corporate certificates regardless of market value whereas Agency debt is assigned a percentage of the prevailing market value), and liquidity (redeeming certificates at prevailing market prices). By removing the comparable liquidity option, even though it has not resulted in any historical losses, all corporate certificates will be at a distinct disadvantage and brokers will be very quick to point that out to credit unions.

While the intent of this proposed change may be to encourage stability in corporate funding, the resulting impact will be the opposite as term funding will move off of corporate balance sheets. This will significantly reduce overall liquidity in the corporate system and lead to heavier dependence on volatile daily and very short term shares funding corporate balance sheets.

Corporates will have to maintain higher levels of short term assets for prudent liquidity and volatility limit conformity, but this will reduce the ability for corporates to generate net interest income to build retained earnings and it could negatively impact corporates' ability to fund credit union lines of credit since corporates will have fewer longer-term assets to pledge as collateral with other funding participants.

This proposal should be removed in its entirety.

Critical Issue #6 – NEV Sensitivity Analyses

We have seen analyses that show that the proposed limitations placed upon a corporate through various NEV tests do not allow the corporate to generate sufficient interest margin to build retained earnings to meet the Agency's proposed capital requirements within the projected time frames. If enacted as drafted, this proposal will inevitably lead to some combination of increased fees being charged to us and forced expense reductions that will adversely impact the level of service and support that our credit union needs. The rule should be revised to allow for corporates to make sufficient income from the balance sheet to grow and invest in innovation for the benefit of all its member credit unions, while exercising an acceptable level of credit and interest rate risk.

In closing, we want to thank the NCUA Board for the opportunity to provide our concerns and recommendations regarding this very important rulemaking. We urge the

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Board to strike an effective and fair balance between preventing a repeat of past corporate failures and allowing a viable corporate system to thrive.

We would ask that NCUA seriously consider another round of proposed rule-making and comment 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.

We want to see it work the right way, and we hope that our comments, along with those of our fellow credit union leaders, will assist the Agency in making that happen.

Sincerely,

Mark G. Holbrook
President/CEO

cc: Lucy Ito, Senior Vice President
California Credit Union League

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