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HERITAGE TRUST
FEDERAL CREDIT UNION

March 5, 2010

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

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

Dear Ms. Rupp:

Heritage Trust FCU thanks you for the opportunity to comment on the proposed changes to NCUA Regulation 704. We support a regulatory environment that does not allow excessive risk-taking. We support your efforts to ensure that this current financial crisis within the corporate credit union network can never be repeated. That said, natural person credit unions need a corporate credit union system and that system needs to be allowed to operate in a safe and sound manner managing, not eliminating, risk while providing value to its member-owners.

While NCUA contends that concentration risk and the lack of liquidity were the determining factors for the current financial situation, we contend that credit related risk associated with the underlying collateral of the private issue mortgage-backed securities coupled with the extreme concentration levels at several corporate credit unions was the core problem. Had it not been for these credit losses the system would not have sustained the volume of OTTI charges it experienced. Liquidity issue was a by-product of the credit problems when US Central lost the majority of its borrowing capacity due to deteriorating credit related to its non-agency mortgage portfolio. Therefore, the final regulation should place priority on credit quality of investment portfolios while allowing more room for managing non-credit related risks. In its current form, restrictions in the ALM modeling section greatly reduce the type of high quality investments in which a corporate may invest due to maturity (WAL) limitations. That leaves the need for some flexibility in managing liquidity risks to provide a corporate the ability to buy floating rate investments to generate necessary earnings. We believe the proposed restrictions contained within the ALM section of the regulation will not allow a corporate to meet required earnings targets and will lessen the value a corporate can provide its members. Our "section-by-section" comments are as follows:

704.2 Definitions:

Adjusted core capital: Perpetual Contributed Capital (PCC) should remain a part of core capital while simultaneously requiring certain levels of retained earnings. As a minimum, "excess PCC" should be capital under the total capital ratio calculations.

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Leverage ratio: Since most corporate credit unions are starting with little to no retained earnings or PCC, it appears that corporates would not be able to use much Non-Perpetual Capital Accounts (NCA) in this calculation. Therefore, a corporate should be able to use 100% of its NCA towards the leverage ratio, not just an amount equal to tier 1 capital.

704.3 Capital:

Callability of PCC: Capital belongs to the membership while minimum capital requirements and PCA provisions protect the NCUSIF. Therefore, the board of directors of a corporate credit union that exceeds the required capital requirements within the regulation should maintain the authority to redeem/call PCC on a pro-rata basis, at its discretion, without regulatory approval.

Treatment of Non-converted MCSD: Non-converted PCC and/or NCA should be treated the same way MCS is treated under the current regulation. Said accounts will remain a risk-asset to the credit unions during the 3-year notice period and should continue to count as capital.

Retained Earnings Ratio Requirements: If the current low rate interest environment continues into the future the 45 basis point retained earnings ratio requirement will be very difficult, if not impossible, for corporate credit unions to achieve utilizing short term deposit of less than 90 days. Although we appreciate NCUA's desire to protect natural person credit unions by requiring minimum retained earning requirements, corporate credit unions must be given the ability to manage some level of portfolio risk to generate sufficient earnings. Therefore, adopt Basel 1 Capital Standards without the added burden of minimum retained earnings requirements. Also, NCUA need to develop methods of consistently measuring capital standards using sound mathematical formulas and historical data. Said requirements should not be based on subjective opinion.

Reservation of Authority (704.3(e)(3): This is confusing. Why discount a capital account that meets the definition and the term set forth by the regulation? The regulation already gives NCUA the authority to require higher minimum capital ratios if risks within the corporate credit union exist. There should be no additional authority granted to disallow a capital account that meets all the definitions of the regulation.

704.4 Prompt Corrective Action (PCA):

Reclassification of Capital Ratings: The proposed regulation appears to give the NCUA the ability to place a well capitalized corporate into a potential PCA situation at any time as most corporates have probably received an individual component rating of 3 sometime over the past 10 years. NCUA needs to develop a consistent methodology in determining a component rating of 3 or worse besides relying on the subjective determination of an individual examiner of OCCU. If a corporate is downgraded to a component rating of 3 or lower, the NCUA needs to allow for an appropriate time frame for a corporate to resolve the deficiencies.

704.6 Credit Risk Management: Single issuer concentration limits are too restrictive and will actually create more credit risk as it forces investing in lower tier issuers. Obligor limits should be increased to 35% of capital to allow diversification within a specific sector limit.

Also for consideration under the single issuer concentration limit is that fed funds/ overnight deposits should be allowed a higher concentration limit than the 25% of capital. Given the low risk profile of the fed funds/overnight market, we recommend that the single issuer concentration limit for overnight deposit transactions be increased to a limit similar to the aggregate repurchase limit for a single counterparty – 100-200% of capital.

704.8 Asset and Liability Management:

Penalty for early withdrawals: Term certificates redeemed by a credit union should be subject to a market based penalty – either a gain or loss -- as long as the corporate has the ability to divest its offsetting asset at a comparable gain or loss, whether or not the corporate actually sells the asset(s).

Weighted average asset life: Allow the portfolio limit to be based on 12-month average assets which would take into account seasonal cash flows. If a hard WAL cap is desired, the cap should be extended to a 3-year WAL for the portfolio to allow some additional flexibility in managing assets and liabilities within a fluctuating balance sheet environment.

Concentration limit per individual member: Corporates should be able to match deposits in excess of 10% from an individual member to the durations of the liabilities. Also, modify the calculation to be based on monthly average assets versus a daily calculation.

Cash flow mismatch sensitivity analysis: It was the credit risk of the underlying floating rate bond collateral that created the financial crisis. This led to spread widening which led to liquidity problems as funds were withdrawn from the system. Therefore, spread widening tests should be modified to exempt securities that do not carry a credit risk component (0% credit risk weighting). In addition, assets risk-weighted at 20% should be subjected to a lower spread widening test (50-100 bps) than the proposed 300 basis point model to reflect their lower credit risk component.

Sample Balance Sheet Used in Preamble: The sample balance sheet in the preamble must have been representative of US Central and WesCorp who did not represent the corporate system as a whole. Therefore, re-model the effects of the proposed changes using more realistic liability percentages for overnight deposits and apply historical spread trends versus spreads taken at one moment in time. Our modeling of this regulation shows that we cannot possibly make sufficient earnings to meet the retained earnings accumulation goals required.

50% slowdown in prepayment speeds: The proposed modeling of an assumption of a 50% slowdown of prepayment speeds is too simplistic and would be incorrect to apply to many asset classes. We recommend the assumption of a 50% slowdown of prepayments portion of the proposal be removed as MBS modeling already incorporates the impacts of prepayment speeds in a variety of interest rate environments. A generic 50% slowdown of prepayments would be difficult to model uniformly across a variety of coupons and structures.

Effective date of ALM revisions: There is no phase-in period for the ALM provisions contained within the proposed regulations; therefore, we recommend a 12-month period of time before this section becomes effective to coincide with the effective date of the new capital standards.

704.9 Liquidity Management

Borrowing limits: The proposed change from today's borrowing authority of the greater of 10 times capital or 50% of capital and shares, to the lesser will drastically reduce a corporate's borrowing ability particularly in times of overall credit union system liquidity tightens. This proposed change will force a corporate to have a more liquid investment portfolio to reduce its reliance on borrowing when liquidity gets tight. While hurting a corporate's liquidity capacity, it at least does not necessarily negatively impact a corporate's earning capacity in the same manner the overall portfolio WAL limit and/or asset-liability mismatch limitations caused by the 300 basis point spread widening test. We would suggest that this is a more effective means of controlling liquidity of assets on a corporate balance sheet than a hard cap on a portfolio's weighted average life (2 years).

Secured borrowings: The proposed regulation limits a corporate's borrowing to 30 days and allows non-liquidity related borrowings to an amount equal to a corporate's core capital amount that exceeds 5%. The 30-day term limit for borrowings not only negatively impacts a corporate's ability to manage its balance sheet risks but also meet member borrowing needs. We would seek to eliminate the 30-day limit on borrowings for liquidity purposes and we would count a member credit union's borrowing as a legitimate liquidity purpose. To more effectively manage interest rate risk, corporates need the ability to match borrowing requests from member credit unions to borrowing the corporate may do to fund that request. Therefore, we recommend eliminating the 30-day term limit for liquidity purpose borrowings.

For the non-liquidity borrowing as allowed within the proposed regulation, we would also recommend eliminating the 30-day term as to participate in this type of borrowing a corporate will need to be well capitalized. At that point, a corporate should be able to use its limited authority to borrow for non-liquidity balance sheet purposes to better manage interest rate and/or liquidity risks which would generally involve longer than 30-day term borrowing to be an effective risk mitigation tool.

704.11 CUSOs

Permissible Activities: The proposed regulation identifies only two approved services for a corporate CUSO – brokerage and investment advisory services. NCUA is aware of the range of CUSOs in which corporates currently have investments. We would recommend that NCUA add those services to the approved list of CUSO services for corporate CUSOs. If not, what criteria will NCUA use to determine appropriate services for a corporate CUSO? Should not control of this remain with a corporate and its members?

704.14 Representation

Term Limits: This appears to be a potentially very disruptive process to the governance of corporate credit unions. We are witnessing a shrinking number of credit unions. Second, we are experiencing heightened concerns related to serving on a corporate board. Therefore, it would seem like the term limits proposed may be a detriment to effective board governance going forward. The membership should determine who serves on corporate boards whether term limits are appropriate and preferable.

Chair Restriction: The proposed regulation continues to disallow the chair of a corporate board from simultaneously serving on the board of a trade association. This has been carried over from the days when corporate boards were interlocked with league boards. Given the clear separation of corporates from trade associations that exists today, we believe this restriction should no longer apply. We would continue to agree with the restriction that the chair of a corporate must be a representative from a natural person credit union member.

704.19 Disclosure of executive and director compensation

Annual Disclosure: For purposes of this proposed section of the regulation, we would recommend that the senior executive officer definition be restricted to the CEO and his/her direct reports. State chartered credit unions already disclose executive compensation on the IRS Form 990 tax returns which are publicly available. The corporate credit union should have the ability to select its own format for disclosing this data to the membership.

Effective Dates for Transition: There are numerous provisions of the proposed regulation that are effective immediately upon final approval by the NCUA board. Most, if not all, corporates will probably be immediately out of compliance with at least one or more of the proposed sections of the regulation. We would recommend there be some minimal amount of time given to comply with all sections of the new rules. Since most corporates are currently operating under an agreement with the NCUA in exchange for a NCUSIF share guarantee, it seems as if there would be minimal risk in providing an appropriate transition period for corporates.

<u>**Summary:**</u> We agree that the recent problems within the corporate system, particularly with U S Central, WesCorp, Members United, Constitution, Southwest, and Southeast Corporates, could have been minimized with tighter regulations and greater oversight. However, to allow a cooperatively owned corporate credit union to provide any real value to its members, it must be afforded some ability to manage risk. The proposed regulation essentially eliminates all risk a corporate could manage in providing products and services to its members. Under this scenario, we do not believe a viable corporate credit union is possible. We do believe the proposed regulation needs substantial revisions and with modifications can still safeguard the credit union system from the systemic risks it has suffered during the recent financial crisis.

Respectfully submitted,

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