Filed via email: regcomments@ncua.gov

March 8, 2010

Ms. Mary Rupp
Secretary to the Board
National Credit Union Administration
1775 Duke Street
Alexandria VA 22314

Dear Ms. Rupp:

On behalf of Allied Credit Union, I thank you for the opportunity to comment on the proposed changes to Part 704, affecting the rules and authorities for corporate credit unions. The activities of the corporate credit unions over the past several years have placed natural person credit unions in an untenable position, and I personally appreciate the role the Administration has played in mitigating the impact on our credit union and the financial lives of our members to date.

Allied Credit Union is a small, community based credit union located in Stockton, California with approximately $19 million in assets and 2,400 members. Allied has been dependent upon its corporate credit union for the provision of settlement and payment services, correspondent services, short and long term investment products, as well as short and long-term liquidity needs. The failure to properly resolve the issues continuing to surround the corporate system today would have a substantial impact on the ability of Allied Credit Union to provide any services to its membership.

I have had the opportunity to speak with many small credit unions about the proposed rule and the continuing problems facing corporate credit unions, and by extension, natural person credit unions, through my role as Chairman of the Credit Union National Association's Small Credit Union Committee and through regular ongoing dialogues. Please let me share with you some of their thoughts:

- In finding a resolution to the corporate credit union issues, the interests of credit union members, and by extension, the needs of natural person credit unions should be the primary focus.
- Most credit unions, including most small credit unions, have made it clear to me that they are unwilling to commit significant amounts of new capital in corporate credit unions operating under the current corporate business model.

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- Small credit unions require access to settlement, payments, liquidity, investments, and other correspondent services. We believe that it would be preferable that the source of these services be entities owned and controlled by credit unions. However, it is clear that not all of these services must be provided by a single entity for each credit union.
- Small credit unions will not accept entities to meet their financial services needs that impose significant risks to them, either in the form of exposure to of the capital invested by credit unions in these entities, or through the share insurance fund. Small credit unions implore the Administration to help prevent another systemic crisis such as the one we just experienced.
- Finally, whatever entities emerge to serve the financial services needs of natural person credit unions, they will require some level of capital from credit unions. I do believe, however, that the entities that succeed will be those that require less capital by assuming less risk, and that offer key services that are effective and of low cost to small credit unions.

I am led to the conclusion that the existing corporate business model no longer serves natural person credit unions well and is no longer viable. I am watching as several groups of larger credit unions are developing cooperative business models to replace the existing corporate model. I believe that a new business model must flow to continue the ability of corporate credit unions to serve natural person credit unions effectively.

I have also heard from many corporate credit unions that they cannot operate under the proposed regulation. I would concur that without radical changes in the corporate credit unions' business model, their viable operation under the proposed regulation likely is impossible. However, many credit unions are calling for a new business model that will provide substantial improvements in operational efficiencies. If corporate credit unions are to continue to play a role in serving credit unions, there will need to be significant changes in both their operations and functions, and substantial revisions in their business models.

I believe that with sufficient changes in the business model, broadly consistent with the model outlined below, corporate would be able to operate successfully under the proposal and serve natural person credit unions' interests well.

A New Model for Credit Union Financial Services Entities

I have concluded that the business entities that meet the financial services needs of natural person credit unions in the future must operate according to a model that is quite different from the current corporate credit union model, in order to provide effective services and to minimize risks to the credit union system. It is possible that one or more of the current corporate could evolve into one of these entities.

In general, the new model should have the following basic characteristics:

Small Balance Sheets

Successful entities will need to dramatically shrink their balance sheets to attract new capital. In reality, the only balances that would need to remain on an entity's balance sheet would be settlement balances.

Provide Settlement Services

This is one of the two critical services that must be protected for small credit unions. Ideally, there would be a single national aggregation point for all such entities to concentrate daily settlement. This would protect credit union influence on the financial system and provide for economies of scale. Because of the need to own a routing and transit number, this is the one service that a corporate entity would be required.

Provide Payment Services

While providing payment services for check collection and share draft processing have been the main purviews of corporate credit unions in the past, these services, as well as many others could be furnished by another entity today, including credit union service organizations. Check collection and share draft processing were services that previously required dispersion due to transportation needs, which have now been eliminated in the new era of Check 21. Economies of scale can be provided by consolidation into a much small number of entities than the current 26 corporates that exist today. Payment and settlement services do not need to be provided by the same entity for any one natural person credit union. In addition, payment services for a single natural person credit union could come from multiple entities.

Meet Short and Medium Term Liquidity Needs Using Off-Balance Sheet Mechanisms

Small natural person credit unions will need to have short and medium term liquidity services. These services can be provided, however, off the balance sheet of the new entity and placing the exposure on the balance sheet of the natural person credit union, where the capital resides and where the risk should properly be placed. The new entity can assist small credit unions in obtaining short and medium term liquidity by using any of several mechanisms, such as:

- Acting as an agent or clearing house for natural person credit unions to buy Federal Funds from other credit unions or financial institutions
- Acting as an agent to facilitate inter-lending among credit unions for longer terms, using peer-to-peer lending systems or other systems
- Securing lines of credit or term loans for credit unions based upon pools of pledged collateral owned by credit unions.

In each of the above examples, the new entity would provide value in assessing risks and serving as agent or clearing house, without assuming risk on their own balance sheet.

Meet Investment Needs

Natural person credit unions will still need to invest excess liquidity. It has been investing directly on the balance sheets of corporate credit unions that have created multiple crises in the past. We can shift the risk from investing by natural person credit unions by moving the investments from the balance sheets of the corporate to the balance sheets of the natural person credit unions. Again, this will place the risk where the capital to support the risk resides. We are seeing examples of this today through programs such as SimpliCD for term investing with other financial institutions. The new entities can provide substantial value and assistance through any of several mechanisms:

- Acting as an agent or clearing house for credit unions to sell Federal Funds to other credit unions or financial institutions.
- Operating or providing access to a money market mutual fund.
- Operating or providing access to a family of other investment mutual funds.
- Providing broker services.
- Providing investment advisory or investment management services on a fee basis.

Correspondent Services

The new entity could provide a full range of correspondent services on a fee basis.

Transformation Will Be Required to Meet Desired Needs

My conversations with industry representatives at all sizes have clearly delineated a change in the priories for entities providing services to natural person credit unions. Settlement, payment services and liquidity were taken for granted, while corporate credit unions differentiated themselves through the offerings on the investment portion of the book of business. We have learned the hard way that it is imperative to change the model to protect settlement, payment services and liquidity in the future.

The critical issue is how we move from the current corporate model to a new model. While it might be simpler to just abandon the current corporate institutions and start up a new entity to meet the new model, I believe that there is value inherent in the existing corporate that should be preserved. Corporates over the years have developed professional expertise in the primary areas of settlement, payments and liquidity services that could only be duplicated at substantial cost to natural person credit unions. In addition, corporates have developed service structures important especially to smaller credit unions.

That said, corporate credit unions must make dramatic changes in order to provide the truly necessary services in the future without continuing the unacceptable pattern of risk taking seen in the past. Corporate credit unions will no longer be able to use the earnings from the investment portfolio to subsidize the costs of settlement, payments, and liquidity. This will require greater transparency and increased efficiency. I believe that it can be done.

The proposed regulation, whether intentionally or unintentionally, assists in driving corporate credit unions to make the changes I believe are needed. I am deeply concerned, however, that there is no clear path from our current situation to the model of the future. While I would not expect the Administration to dictate that path, I believe that all of us, including the Administration, must take an active role in assisting in this transformation.

Natural Person Credit Unions Must be Protected Against Disruption

The obvious effect of this regulation and the ensuing redefinition of the role of a corporate or some new entity will be the need to develop and market a new model to its current and potential membership. There could be substantial disintermediation during this period as natural person credit unions determine which entity in the future is best capable of meeting its ongoing needs. What is important is the need to provide an environment that allows natural person credit unions to perform the required due diligence on these redefined entities and make the best possible choice for their members. The Administration must take an active role in ensuring that we have an opportunity to make that choice.

I am concerned that without a final rule on the regulation, without a clear understanding of the status of current capital in relation to legacy assets, and without the ability to properly evaluate potential new service models, some corporate credit unions are currently making capital calls and threatening loss of critical services unless contracts are executed prior to the resolution of these issues. Natural person credit unions, especially small natural person credit unions, need the time, absent of threat, to come to understand the ramifications of the finally adopted regulation once promulgated. I would hope that the Administration would use its authorities to ensure that this will happen.

In addition, not all entities will survive into the future, either by the choice of the entity, or the choice of the entity’s membership. The Administration, in this proposal, has not fully addressed its role in the transition process and I would encourage it to do so.

Addressing the Issue of Legacy Assets

I appreciate the significant problems that exist in resolving the issue of the legacy assets held by the corporate credit union system and I believe that the Administration will provide an appropriate solution. I would ask that the guiding light of that resolution should be continued transparency and the minimization of the losses incurred by natural person credit unions in solving this problem.

I am also concerned that I may need to make business decisions on our credit union's future providers of the services I have discussed earlier prior to understanding the method of the resolution of the legacy asset issue. I would recommend that the implementation date for the final rule on this proposed regulation be delayed until after the disclosure of the method of resolution of the legacy asset rule to provide adequate time for my credit union to perform its due diligence.

Allied Credit Union Endorses Specific Changes Noted in Letter from CUNA

I will not comment regarding specific areas involving capital and prompt corrective action, corporate governance issues, derivatives, CUSOs, and the need for a third party review of the Administration's assumptions and analyses used to develop the proposal, other than to state that we fully endorse the comments furnished by the Dan Mica on behalf of the Credit Union National Administration in his letter regarding the proposed regulation. I have had the opportunity to participate in the discussions of its Corporate Task Force over the past year and his thoughts represent the desires of Allied Credit Union and, I believe, the desires of most natural person credit unions, especially smaller credit unions such as ours.

Conclusion

Natural person credit unions are going through the most disruptive event that I can remember in my experience over the last 30+ years. We endorse the Administration's desire to prevent a reoccurrence in the future. That said, we must go further to ensure that the future risks of disruption to settlement, payments and liquidity are prevented.

Our focus and priorities must change to preserve these three pillars of service. While I can go outside the credit union system to obtain these services, I believe that in the long term, my members will be best served by finding a credit union owned and controlled solution. I believe that a corporate credit union can be that solution, provided that it is willing to transform its business model to protect my membership from future disruption. I would ask that your final regulation provide the framework to permit this outcome to happen.

We will be required to go through a period of significant change – a transformation – that will require active participation by all of us, natural person credit unions, corporate credit unions and the Administration. I would hope that the Administration will more clearly define its role in this transition and provide the support needed for natural person credit unions to adapt to a new model. Smaller credit unions, especially, will need some assistance and protection from potential disruption.

Finally, all natural person credit unions have been affected by the corporate meltdown. There are multiple solutions to solve the problem or obtain the requisite services in the future. I believe that by working cooperatively, natural person and corporate credit unions can craft a least cost solution that will protect us going forward. I would encourage all of us to look together to find that solution. I would hope that the Administration will provide flexibility in its final rule for the corporate system in Part 704 to permit that to happen.

Again, thank you for the opportunity to comment on this proposed regulation. Please feel free to contact me directly should you require further clarification on any of these comments.

Sincerely,

Frank Michael
President/CEO