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March 8, 2010

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

Dear Ms. Rupp,

Georgia Central Credit Union appreciates the opportunity to provide feedback to the National Credit Union Administration (NCUA) on the proposed regulation for corporate credit unions. Recent events throughout the national economy have made clear that change is necessary within the corporate credit union network. This response is written in the spirit of our commitment to make those changes that are necessary to continue to provide value to the natural person credit union network.

On November 19, 2009 the NCUA issued a Proposed Rule for Corporate Credit Unions with a request that stakeholders provide comments prior to March 9, 2010. The commentary on the following pages represents Georgia Central Credit Union's position on the issues addressed by the proposal.

To say that the NCUA faced a daunting task in rewriting this regulation is an understatement. It is not surprising that the result is a lengthy and complicated document. In the NCUA's preamble to the proposed rule they acknowledge that corporate credit unions are a valuable resource to some credit unions and essential to the operations of smaller ones. Georgia Central agrees that a cooperatively-owned correspondent financial institution network adds value to natural person credit unions through the aggregation of payment, liquidity, investment and risk management functions. We believe that the current environment provides a catalyst to create a corporate credit union network that is more efficient with a more equitable balance of capital and risk. However, in order to achieve this vision the proposed changes to Regulation 704 must provide a means to repair the existing problems and flexibility to retain the viable components of the corporate credit union network.

The severe nature of the recent economic crisis has resulted in losses within the financial services industry of $1.1 trillion in the U.S. and $1.7 trillion worldwide *(data source: Bloomberg)*. The NCUA's preamble to the proposed regulatory changes states, "These modifications are intended not only to avert a repeat of the recent problems encountered in the corporate system but also to anticipate new problems that might occur." We believe the proposed regulatory changes do serve to protect the credit union network from drastic upheavals within the investment and credit markets. However, in designing a regulation to safeguard against rarely encountered levels of market risk, the NCUA has eliminated the ability for corporate credit unions to provide value during times of less or even normal market volatility.

Specifically, we agree in principal with the proposed provisions to lower investment concentration limits and add sector limits. The introduction of the concept of weighted average life limits will mitigate risk. The proposal to require corporate credit unions to perform credit shock modeling is proper and an activity that many already perform. However, the proposed credit shock modeling limits are so restrictive that this provision alone will eliminate the ability for any corporate credit union to manage a balance sheet that generates positive net income.

Many provisions of this proposed regulation have the potential to impact Georgia Central's member credit unions in a negative way. A number of its requirements would have the effect of eliminating or severely restricting access to services that credit unions need and jeopardize the competitive rates and critical support that corporate credit unions provide. These harmful effects would impact credit unions of all sizes. Even the largest institutions that may have the ability to assemble a group of vendors to replace the most essential corporate products would be affected by the cost and operational burden of converting to these alternatives as well as a long-term reduction in efficiency. Without an aggregation-driven cooperative corporate, most small and medium-sized credit unions would be unable to acquire cost-effective solutions for their settlement, payment and investment needs. In addition to requirements that are individually problematic, the overarching threat to natural person credit unions lies in the fact that an application of this regulation as written does not allow for a viable business model for corporates.

Further, many of the provisions can be characterized as reaching beyond the scope of addressing the risks that we all believe *should* be mitigated. Such provisions give the agency broad authority over corporate governance and decisions that should be left to the discretion of a corporate's elected officials. While we have attempted to make constructive suggestions throughout the commentary below, at times the only practical recommendation is to suggest that a provision be eliminated altogether.

Thank you for the opportunity to comment on the proposed regulations and please feel free to contact me if you desire further clarification or to comment on Georgia Central's response.

Sincerely,

Greg Moore

Greg Moore
President/Chief Executive Officer
Georgia Central Credit Union

cc: Georgia Central Board of Directors
Georgia Central Supervisory Committee
Mr. Scott Hunt, OCCU
Mr. Robert Dean, OCCU
Mr. George Reynolds, Georgia Department of Banking and Finance
Mr. Mike Anderson, Georgia Department of Banking and Finance

Critical Proposed Changes to Regulation 704

§704.8(e) and (f)
Credit Risk Shock and Prepayment Speed Slowdown Tests and NCUA's Model for Retained Earnings Growth

Commentary: Credit Risk Shock
The NCUA proposed rule introduces two new NEV tests: a credit widening NEV test and a credit widening plus 50% slowdown test. The draft regulation calls for a 300 bps *credit spread* shock to base case pricing for all balance sheet items. The proposed rule indicates that regulatory triggers would be at the same level that is applied to the +300 bps interest rate shock test (i.e., 15% maximum decline for NEV changes and a 2% floor on the NEV ratio).

For fixed rate instruments, this will slightly increase the amount of risk assigned, as the same 300 bps decline will be discounted at a lower rate in the credit shock environment. However, for floating rate instruments, the impact will be much larger. The credit spread shock will apply to the entire life of the floating rate instrument, effectively converting it to a fixed rate for measurement purposes. Floating rate instruments are normally attractive investments for a corporate as they react quickly to changes in interest rates giving relatively stable price profiles; their attractiveness would be eliminated under this test.

Our analyses indicate that there is no combination of credit-worthy assets, with an aggregate two-year average life and limited extension risk, which can generate sufficient margin to attract funding *and* pass a 300 bps credit shock test.

Historic analysis indicates that 100 bps of credit spread widening would be an unusual and rare event in the market sectors allowed under the new regulation. Over the last 15 years, excluding recent events, credit card and auto ABS credit spreads to LIBOR widened to a maximum of around 50 bps, and generated a standard deviation of spread volatility of around 10 bps.

There is a significant difference between Agency issued instruments and other securities. Debt of Government Sponsored Entities (GSEs) would not carry concentration limits in the proposed rules. These securities trade in very large and liquid markets. Therefore, we recommend using a lower credit spread shock, for example 50% of the regular spread shock, for securities issued by GSEs.

Recommendation
The Proposed Rule should be amended to a 100 bps credit spread widening and a 35% NEV volatility tolerance limit and there should be a limited shock for GSE debt. Consideration should also be given to scaling the credit shock to the weighted average life of the instrument.

Setting the credit shock test at 100 bps widening – double the historical average – is a more reasonable and realistic requirement. Even at a 100 bps credit shock, a NEV volatility limit of 35% decline is needed to accommodate the impact of floating rate investments carrying the loss to maturity.

Commentary: Prepayment Speed Slowdown Test

While ABS prepayment speeds do change modestly from time to time, they appear to be driven more by economic events rather than interest rate or credit events. There is no factual or historic basis for halving ABS speeds in the context of a credit risk shock test. MBS pay downs are subject to interest rates and economic events, and an arbitrary factor of a 50% slowdown may at times be warranted. Depending on economic conditions a 50% slowdown may be too much or too little of a prepayment shock to gauge the appropriate portfolio composition.

The investment portfolio aggregate weighted average life limit of two years, along with the credit shock and prepayment speed slowdown tests, will effectively make holdings in MBS (the single largest asset backed sector) virtually impossible. However, there is clearly a significant difference between private label MBS and Agency issued MBS, as in the proposed rule GSEs do not carry any concentration limitations.

The proposed rule mitigates risk from cash flow mismatching in several ways: the two-year aggregate WAL limit, parallel yield curve shift tests, the spread widening test, sector concentration limits and the liquidity provisions that require corporate credit unions to keep sufficient liquidity on hand to cover settlement activity. Measuring and reporting sensitivity to slowing prepayment speeds is important for corporate credit union portfolio management; however, adding it to the extensive list of risk limits does little to enhance regulatory oversight.

Recommendation

Eliminate the combined spread widening and prepayment speed slowdown test from the final rule.

Commentary: NCUA's Model for Retained Earnings Growth Under Proposed Investment and ALM Limitations

Pages 99-101 of the NCUA proposed rule preamble contains an example of the ability to grow earnings under the proposed investment and ALM limitations. We believe this example does not represent an attainable or realistic outcome. The NCUA's example does not include any cost for new capital that must be attained and assumptions on spreads and other factors are not reasonable or achievable.

For instance, in the NCUA example, the model works 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. Allocating 30% of the portfolio to the student loan sector represents a significant exposure in student loans versus the overall ABS market insofar as a corporate could even find enough of these risk assets to make the model work. This single sector of the

NCUA example balance sheet accounts for 75% of the interest income, and 59% of net interest income (20 of 34 bps) comes from 10% of the portfolio with that 10% of the portfolio yielding LIBOR+200. This represents excessive exposure and is simply not representative of a long run average for sector yield.

Current market intelligence indicates that there is one active originator of private label student loans. And, unlike the L+200 spread that the NCUA's example portends to achieve on a 0.5 year AAA senior security, spreads on student loan ABS are actually around L+50 for 1.5 year AAA, L+100 for an 8 year AAA, and L+350 for a 6.5 year AA. Swapping 10% of the portfolio at L+200 for a more attainable long run average of L+50 would make the net interest margin fall from 34 bps to 17 bps, leaving net income of 4 bps. The only time AAA ABS traded in at L+200 is during the once-in-a-lifetime market disruption in 2008-2009.

There are also faulty assumptions in the funding mix suggested by the NCUA's example. Using 66% of funding in the form of certificates when the proposal seeks to abolish the payment of premiums on early withdrawals 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. Any change in the funding mix with lower volume and/or shorter average lives will cause the volatility limits to be exceeded by greater amounts.

Recommendation

The new spread widening NEV tests and cash flow mismatch constraints in the proposed rule need to be amended in order to allow for a viable business model for corporate credit unions.

Because the examples provided in the preamble do not represent achievable long run averages or a realistic reflection of the constraints contained in the proposed rule, we created a revised model to illustrate a more reasonable and realistic outcome. This revised model is based on a $10 billion dollar balance sheet for example purposes and assumes no growth in assets or asset mix over the seven year time horizon. Funding has been modified to include a capital note of $400 million (4% capital assuming a $10 billion balance sheet) issued on day one, priced as floating at a spread of 200 bps to LIBOR. The adjusted model also assumes that fees and operating expense will increase in line with inflation at an assumed rate of 2% per annum.

As the table below shows, after adding the 4% capital note, and adjusting fees and expenses for inflation while keeping other parameters consistent with the NCUA's example, net income drops to 12 bps from 21 bps. An assumed cost of capital of 200 bps may be viewed as excessive. However, as capital is needed on day one, before a corporate is in a position to demonstrate its ability to generate revenue with very little risk, this assumption could be seen as somewhat optimistic. With a capital cost of 200 bps and the spread on private label student loans adjusted to a more reasonable level of an aggregate 50 bps, the model shows a *negative* net income spread of -3 bps.

Fundamentally, the examples below confirm that a corporate cannot make enough net interest margin, starting from zero RUDE, with the credit shock and pay down shock risk limits as proposed. As these are purported to limit the average life gap to two months, it is equally clear that no sustained yield curve could generate anything but a very thin net interest margin.

	NCUA EXAMPLE		ADJUSTED FOR CAPITAL		ADJUSTED FOR SPREAD	
ASSETS	**PERCENT OF BALANCE SHEET**	**SPREAD TO LIBOR**	**PERCENT OF BALANCE SHEET**	**SPREAD TO LIBOR**	**PERCENT OF BALANCE SHEET**	**SPREAD TO LIBOR**
FFELP Student Loans	20%	25	20%	25	20%	25
Private Student Loans	10%	200	10%	200	10%	**50**
Auto ABS	20%	25	20%	25	20%	25
Credit Card ABS	10%	30	10%	30	10%	30
Other ABS	10%	10	10%	10	10%	10
Overnight	30%	0	30%	0	30%	0
TOTAL	100%	**34**	100%	**34**	100%	**19**
SHARES AND EQUITY						
Overnight Shares	30%	0	30%	0	30%	0
Certificates	70%	0	66%	0	66%	0
Capital Note	0%	0	**4%**	**200**	4%	**200**
TOTAL	100%	**0**	100%	**8**	100%	**8**
NET INTEREST MARGIN		**34**		**26**		**11**
OTHER INCOME		**17**		**18**		**18**
OPERATING EXPENSES		**30**		**32**		**32**
NET INCOME		**21**		**12**		**-3**

The following revised model illustrates an investment portfolio projected over a six-year period using realistic and prudent sector mixes and spreads.

LONGER-TERM ANALYSIS

	START		END OF YEAR 3		END OF YEAR 6	
	PERCENT OF BALANCE SHEET	**SPREAD TO LIBOR**	**PERCENT OF BALANCE SHEET**	**SPREAD TO LIBOR**	**PERCENT OF BALANCE SHEET**	**SPREAD TO LIBOR**
ASSETS						
Loans	10%	51	10%	56	10%	57
ABS - Autos	18%	41	18%	38	18%	33
ABS - Credit Cards	17%	46	17%	43	17%	38
FFELP Student Loans	5%	51	5%	48	5%	43
Structured Agency	15%	31	15%	36	15%	37
Bank Floaters	5%	26	5%	30	5%	32
Other Short-term	8%	9	8%	13	8%	15
MBS - CMBS	7%	97	7%	101	7%	103
Overnight	15%	1	15%	5	15%	6
TOTAL	100%	**37**	100%	**38**	100%	**37**
SHARES AND EQUITY						
Overnight Shares	50%	0	50%	0	50%	0
Certificates	46.0%	0	45.6%	0	45.2%	0
Capital Note	4%	200	4%	200	4%	200
RUDE	0%	0	0.44%	-366	0.97%	-464
TOTAL	100%	**8**	100%	**6**	100%	**3**
NET INTEREST MARGIN		**29**		**31**		**33**
OTHER INCOME		**17**		**18**		**19**
OPERATING EXPENSES		**30**		**32**		**34**
NET INCOME		**16**		**17**		**18**

PROJECTED RETAINED EARNINGS: YEARS 3 AND 6

RETAINED EARNINGS	PROJECTED	TARGET
YEAR 3	$44.4mm	$45mm
YEAR 6	$97.3mm	$100mm

RISK MEASURES: YEARS 1, 3 AND 6
NCUA PROPOSED TESTS AND LIMITS

NEV SHOCKS	MAXIMUM	LIMIT
RATES +300bps	-14.0%	-15%
CREDIT +300bps	-84.3%	-15%
+PAYDOWNS -50%	-92.6%	-25%

RISK MEASURES: YEARS 1, 3 AND 6
GEORGIA CENTRAL PROPOSED TESTS AND LIMITS

NEV SHOCKS	MAXIMUM	LIMIT
RATES +300bps	-14.0%	-15%
CREDIT +100bps	-30.3%	-35%
+PAYDOWNS -50%	-32.7%	-40%

Impact to Natural Person Credit Unions

The proposed 300 basis point spread widening test and the additional test for slowing prepayment speeds by 50%, with their associated NEV limits, restricts the ability of corporate credit unions to mismatch cash flows. This restriction is taken to such a degree that, given the mix of available credit worthy investments, corporate credit unions will likely not be able to generate a positive net income by relying on net interest income. The reduction in overhead expense or increase in fee income necessary to achieve the earnings targets proposed under the new investment rules would either reduce corporate credit union staff below critical levels or eliminate the competitive advantage of owning a corporate credit union. In effect, the proposed 300 basis point spread widening test and the corresponding NEV limits eliminate the value of the corporate credit union charter.

§704.3(a)
Time Period for Leverage Ratio Attainment

Commentary

The proposed rule requires corporate credit unions to achieve a 4% leverage ratio after three years with alterations for the calculation of that ratio after year one and year three. During the first year following implementation of the final rule corporate credit unions may include retained earnings, PIC and MCS in the calculation of the 4% Total Capital requirement. After year one corporate credit unions may apply retained earnings, PCC and NCA (in an amount that does not exceed retained earnings plus PCC) in the calculation of a 4% Total Capital (modified leverage ratio) requirement. The one year window to attain the modified leverage ratio is a significant concern because it will require corporates to bring in new capital or, at a minimum, convert existing MCA to the new NCA and PCC during a time when significant issues still remain with regard to legacy assets for some corporates.

Most corporate credit unions are currently undercapitalized with little or no retained earnings and total capital that consists exclusively of three-year notice MCAs. In order to comply with the 4% modified leverage ratio requirement that starts 12 months following the publication of the final rule, corporate credit unions may only utilize NCA in an amount equal to PCC plus retained earnings. Because most corporates do not have five-year MCAs at present, a conversion of three-year MCAs to a combination of NCA and PCC within 12 months of the final rule is the most logical action to achieve the 4% modified leverage ratio. Most corporate credit unions also will have to ask their member credit unions to contribute substantial additional capital dollars as current MCA balances do not add up to a 4% capital-to-assets ratio.

Due to a lack of sufficient retained earnings at most corporates, credit unions will be asked to contribute roughly 4% of their corporate credit union deposits as contributed capital within 12 months of the final rule's publication. Many natural person credit unions will likely be unable or unwilling to contribute additional capital in such a short amount of time as corporate credit unions will be managing legacy assets as well as adapting to the new business models that flow from the revised Regulation 704. This rush to achieve a 4% leverage ratio may lead natural person credit unions to pull deposits from the corporate system and result in severe liquidity concerns for corporate credit unions.

Some corporate credit unions may choose a strategy of reducing asset size as a mechanism for achieving higher ratios of capital to assets. If this can be accomplished in a safe and sound manner the requirement to utilize daily average net assets in the calculation will overstate the assets used for the calculation of capital ratios. The NCUA should consider allowing a corporate credit union to choose month-end assets rather than daily average assets in the calculation.

Recommendation
Extend the time period for attaining the risk-based capital ratios to three years and clarify language in the proposed rule that discusses attainment of the leverage ratio to coincide with a time period of three years. Allow for utilization of either month-end or daily average assets in the calculation of capital ratios.

Impact to Natural Person Credit Unions
Natural person credit unions likely will be asked to contribute additional perpetual capital as a requirement for depositing funds at a corporate credit union. If the proposed rule is passed, those additional capital dollars will be required within 12 months of the rule becoming final. Natural person credit unions whose boards of directors are not willing to contribute capital dollars will likely be required to move deposits out of their corporate credit union after a reasonable transition period.

Phase-out of Capital Level Forbearance

Commentary

Corporate credit unions are subject to a variety of regulatory limitations on deposit taking, lending and investments that are based on levels of total capital. The NCUA has currently granted corporate credit unions forbearance from many of these requirements by allowing the utilization of November 2008 capital levels for certain limits. This forbearance allows corporate credit unions the ability to continue offering natural person credit unions service at levels that do not disrupt the normal business activities between corporate credit unions and natural person credit unions. The forbearance granted by the NCUA is to expire upon publication of the final rule.

The November 2008 capital levels waiver gives forbearance for several regulatory requirements although NEV volatility and the NEV ratio are not included. This creates a situation where corporate credit unions cannot build retained earnings because the investment of funds is greatly restricted.

Recommendation

The NCUA should consider phasing out the forbearance so as not to disrupt normal business activity at natural person credit unions. The NCUA should also consider granting forbearance from NEV ratio and NEV volatility limits for corporate credit unions that submit a capital restoration plan as a means to allow corporate credit unions the ability to generate retained earnings through net interest income.

§704.8(c)
Prohibition of Redeeming Certificates at a Premium

Commentary

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. 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 and 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, 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 daily and 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. Also, 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. If a corporate credit union were worried about a sudden outflow of liquidity during periods of market stress, a widening of the bid/ask spread would have the desired effect of limiting redemptions. In extreme conditions, a suspension of redemptions could be implemented.

Recommendation
Leave the current rule as is for certificate redemption.

Impact to Natural Person Credit Unions
Restricting the ability of corporate credit unions to pay a premium on certificate redemptions would restrict the investment options available to natural person credit unions. Corporate credit union certificates would be less advantageous versus Agency debentures unless higher liquidity risk premiums were offered. Reductions in the amount of corporate credit union certificates held at the natural person credit union would in turn lower available credit at the corporate. In a normally functioning market, redemptions at par, when a premium is suggested by market rates, would lower potential income for natural person credit unions. Corporate credit unions may be less able to generate earnings and less able to extend credit if this proposed rule is implemented while the risk to capital shareholders is likely increased rather than decreased as intended.

§704.20
Limitations on Indemnification Payments

Commentary
The proposed regulation adds section 704.20 – Limitations on golden parachute and indemnification payments. Proposed 704.20 sets forth numerous factors regarding permissible and prohibited indemnification payments for Institution-Affiliated Parties (IAPs). Strict criteria are recommended in the proposed rule for allowing indemnification payments for the protection of volunteer directors during actions or proceedings initiated by the NCUA or other state supervisory authority.

This proposed rule imposes what appears to be unlimited personal and professional liability risk for corporate directors and management with respect to the decisions that are made in carrying out their official responsibilities. As a result, it will be difficult, if not impossible, to maintain volunteers or management without indemnification for actions taken while performing their professional responsibilities. Qualified and knowledgeable directors and management are crucial for a corporate or any entity to succeed. The proposed change seems to inflict consequences that other financial regulators do not impose on the organizations that they regulate.

The proposed limitations on indemnification payments are similar to those utilized by the FDIC. However, corporate credit union directors differ from the typical bank director in that they are not holders of common equity and they are not compensated for serving on the corporate credit union board. Bank directors would likely have a reduced potential of being sued by the FDIC and would likely have more personal resources to defend themselves. Corporate credit union directors have a very real exposure to actions brought by the NCUA as demonstrated by the pending lawsuit against WesCorp which was initiated by WesCorp members but assumed by the NCUA who acts as the membership during conservatorship.

Recommendation
Continue to allow corporates to provide, at their discretion, indemnification coverage for directors and management incurred while performing duties that are not provided by insurance.

§704.2 Definitions
Available to Cover Losses That Exceed Retained Earnings-Prohibition on Replenishing Capital

Commentary
The ACCU, CUNA, credit unions and others have continued to express concerns with the regulatory mandate to permanently deplete capital based on estimated losses created by OTTI models with no ability for corporates to replenish capital back to existing capital holders if actual losses are less than projected. GAAP does not require the treatment being applied by the NCUA, which is covered in the Letter to Credit Unions 09-CU-10 and now included in the revised definitions in the proposed rule.

Further, as part of its Accounting for Financial Instruments project, it is possible that the FASB will change the credit impairment model standards in 2010 to allow OTTI reversals as loss projections improve. Therefore, corporates that have taken prior OTTI charges may be able to reverse those charges as loss projections improve. NCUA regulatory accounting treatment should allow for the same accounting treatment as national standards and not permanently deplete credit union capital based on projections, which will continually change.

Recommendation
The NCUA should not require permanent depletion of capital based on estimated OTTI model predictions and should allow for a mechanism to exist where corporates would be able to replenish capital back to existing capital holders if actual losses are less than projected.

In separate communications and discussions with the NCUA, the ACCU developed a model and mechanism that would facilitate the ability of member credit unions to recapture depleted capital by having corporates segregate and measure the performance of previously impaired legacy assets from all other assets. Future recoveries in value could be available to return to the original member contributed capital holders in the form of a "paid in kind" PIC dividend; once a corporate met all regulatory hurdles, the corporate's board could determine that any portion of the paid in kind PIC balance could be redeemed in cash. The corporate credit union would thus possess the right, but not the obligation, to pay recovery dividends. This, or some other mechanism to replenish the capital of credit unions, should be allowed in order to lessen the strain on the industry.

In addition, in these communications and discussions, corporate credit unions have advocated for the NCUA to utilize the Stabilization Fund to absorb future impairments on legacy assets, acting as a firewall to protect the value of newly contributed capital. Any recoveries to legacy assets would first have to be applied to the Stabilization Fund to restore previous depletions before it could become available to restore previously depleted capital.

Impact to Natural Person Credit Unions

The proposed rule mandates the immediate depletion of ownership capital if retained earnings fall below zero. However, there may be occasions when a negative balance in retained earnings is temporary and/or it makes economic sense to operate with negative retained earnings for a sustained period of time. Recent FASB decisions to change accounting rules for investment securities and potentially for loans suggest that some flexibility in regard to capital planning should be allowed to compensate for unforeseen changes to accounting methodology. Natural person credit unions could be subject to capital depletions without the potential for remuneration during periods when retained earnings fall below zero, even if those periods are temporary or a result of non-financial losses.

§704.9(a)(3) and (b)(1)
Liquidity Rules for Cash and Cash Equivalents and Borrowing Limits

Commentary

This section of the proposed rule requires a corporate to keep a sufficient amount of cash and cash equivalents on hand to support its payment system obligations, limits corporate credit union borrowing for liquidity purposes to 30 days and restricts borrowing for non-liquidity purposes unless the corporate has a 5% core capital ratio. Also required is an ongoing evaluation of member liquidity needs and contingency funding plans that document sources of liquidity that are available to service an immediate outflow of funds.

The proposed rule regarding sufficient cash on hand to meet payment system obligations is vague. If both an evaluation of needs and a contingency funding plan are required, these two analyses should be reviewed in conjunction with one another to determine if sufficient liquidity is available to meet member needs. If not, regulatory or remedial action should ensue. An open ended regulation to keep cash on hand is an inefficient use of liquidity and regulation.

The proposed restriction on borrowing for non-liquidity purposes unless a corporate credit union has a 5% core capital ratio is excessively prohibitive. This proposed regulation would prevent an adequately capitalized corporate credit union from extending term credit to members that is, in turn, asset/liability matched to external funding. Asset/liability matching is a common risk mitigation practice in use in today's corporate credit unions.

Further, the proposed regulation limits secured borrowing for non-liquidity purposes to an amount equal to the difference between core capital and 5% of moving DANA. If core capital is 5% of DANA and the limit is the difference between 5% and 5%, the limit is effectively zero. Corporate credit unions would be restricted to term borrowing in amounts that were limited to the amount of core capital that exceeds 5%.

Recommendation
Remove the cash on hand provision from the proposed regulation. Allow corporate credit unions that are adequately capitalized with 4% of core capital to DANA to engage in secured borrowing for non-liquidity purposes up to 10% of DANA.

Impact to Natural Person Credit Unions
Natural person credit unions would experience a decrease in available credit at corporate credit unions. Term loans with corporate credit unions would likely be eliminated under the proposed regulation.

§704.11(e)
Permissible Activities for Corporate CUSOs

Commentary
The proposed rule limits permissible corporate CUSO activities to: brokerage services, investment advisory services and other categories of services as approved in writing by the NCUA.

Only a few activities are allowed. Item processing, small business underwriting and data processing are not listed as permissible. Many corporate credit unions have corporate CUSOs that are profitable, pose little risk to the organization and are engaged in activities that are not listed on the proposed rule's permissible list. What is to become of these businesses and the credit unions that rely upon their products and services? Future activities that may be ideal for corporate CUSO business models may be hindered because each new type has to be approved through regulation for the network as a whole.

Recommendation
Strike the proposed changes to regulation 704.11 and retain the current version.

Impact to Natural Person Credit Unions

The proposed rule would restrict the ability of natural person credit unions to partner with each other and their corporate credit union to form mutually beneficial businesses. Successful corporate CUSOs engage in data processing, item processing, small business loan underwriting and certificate of deposit brokerage, among other services. Natural person credit unions enjoy the economic benefits of economies of scale and scope derived from corporate CUSOs. The proposed rule would eliminate the economic benefit of owning a CUSO to corporate credit unions and in many cases force natural person credit unions to develop and finance these opportunities less efficiently.

§704.8(k)

10% Deposit Concentration Limit

Commentary

Effective 30 months after the rule is final, a corporate credit union is prohibited from accepting investments including shares, loans and contributed capital from any one member in excess of 10% of average assets.

This proposed change will drain liquidity from the system by forcing credit unions to place funds outside of the corporate system resulting in less efficient deposit processes and possibly larger risks for credit unions. This proposed limitation places regulatory constraints on corporates that no other regulated financial institutions are required to follow. New regulatory restrictions, coupled with the bank capital standards that corporates will be required to achieve, will make it very difficult for corporates to compete in the financial services marketplace. Credit unions can choose to invest an unlimited amount of funds in banks as long as proper due diligence is conducted. They should not be precluded from investing those funds in another credit union (corporate) as long as they conduct the same due diligence.

Recommendation

Credit unions should be able to make their own assessments of the value and risk they want to assume and an arbitrary limit placed on corporates should not be put into effect. An alternative solution to achieve the NCUA’s objectives with this proposed change could be that deposits from one source should be limited to the greater of 10% of a corporate’s assets or 100% of a corporate’s assets that carry a risk weighting of 20% or less. Another alternative would be to require large depositors to contribute capital at the corporate credit union that is accepting its deposits.

Impact to Natural Person Credit Unions

Large natural person credit unions will either be required to join, and likely, capitalize multiple corporate credit unions or find other counterparties for investments and credit. Corporate credit unions with a small number of large natural person members will probably be required to merge into a larger corporate credit union. Loss of large deposits and established business partnerships may reduce the amount of liquidity at corporate credit unions and increase operating expense to assets ratios, the effect of which will impact pricing and other aspects of the value proposition provided to the entire membership, as well as the viability of the corporate more generally.

§704.2 Definitions: Adjusted Core Capital (2)
Investments in and Loans to CUSOs are Deducted from Core Capital

Commentary
Most corporate credit union investments in CUSOs are structured as Limited Liability Company partnerships (LLCs) and GAAP requires that corporates report these as equity method investments. Income at the CUSO is generally booked as an increase to the equity investment at the corporate. In this case a profitable CUSO would result in an increase of the equity investment, which would result in increased core capital requirements. A one-for-one offset of CUSO income with additional capital requirements would negate the financial benefit of owning a CUSO.

The Basel-based capital requirements in the proposed regulation should capture the appropriate capital necessary to safely lend to or invest in a CUSO. Requiring a corporate to offset core capital dollar for dollar with loans to CUSOs eliminates the benefit of using debt versus equity to finance an enterprise.

Current regulation stipulates that the aggregate of all investments in CUSOs not exceed 15% of capital with the ability to lend an additional 15% of capital unsecured and an additional 15% of capital secured to CUSOs. We feel that these limitations combined with appropriate supervision of investing and lending are sufficient to maintain the safety and soundness of corporate credit unions.

Recommendation
Remove the proposed core capital offset for investments in and loans to CUSOs.

Impact to Natural Person Credit Unions
The proposed rule would restrict the ability of natural person credit unions to partner with each other and their corporate credit union to form mutually beneficial businesses. Successful corporate CUSOs engage in data processing, item processing, small business loan underwriting and certificate of deposit brokerage, among other services. Natural person credit unions enjoy the economic benefits of economies of scale and scope derived from corporate CUSOs. The proposed rule would eliminate the economic benefit of owning a CUSO to corporate credit unions and in many cases force natural person credit unions to develop and finance these opportunities less efficiently.

§ 704.4(k)
Remedial Actions Towards Undercapitalized, Significantly Undercapitalized and Critically Undercapitalized Corporate Credit Unions

Commentary
Proposed 704.4(k) covers "remedial actions towards undercapitalized, significantly undercapitalized, and critically undercapitalized corporate credit unions," equating to leverage ratios of less than 4%, 3% and 2% respectively. The NCUA, in the proposed regulation, reserves the power to lower a corporate credit union's PCA category based on criteria other than the capital-to-assets ratio.

The proposed rule states that a corporate credit union may be conserved by the NCUA if its leverage ratio falls below 4% and it does not submit an approved capital restoration plan. A corporate credit union may be conserved if its leverage ratio falls below 3% and the NCUA doesn't think it can raise capital. A corporate credit union may be conserved if its leverage ratio falls below 2% with no further proof necessary.

The current regulation requires corporate credit unions to submit a capital restoration plan and then the OCCU issues back a capital directive. Nothing further is prescribed by regulation. In fact, the conservatorship powers used for U.S. Central and WesCorp in addition to the powers specified in corporate credit unions' supervisory agreements are from the Federal Credit Union Act.

The proposed regulation moves those powers into Regulation 704 and lists specific actions the NCUA could or would take as a corporate's PCA category drops. One thing that is concerning about moving these powers into 704 and listing tactical actions at predetermined capital levels is that once a tactical action is in the regulation, the NCUA staff member may feel compelled to take those actions because they are specifically spelled out (not necessarily prescribed but certainly suggested). The old regulation kept tactical options open by stating the NCUA would grant a "capital directive." Also, management and governance of the corporate is effectively transferred from its owners to the NCUA through their list of permissible actions. One concern is that, if the NCUA feels as though it needs to take control of management and governance, members will lose confidence and pull deposits. Additionally, it puts a large burden on the NCUA to manage and govern the corporate credit union industry when all corporates are undercapitalized, such as will be the case when this rule is adopted.

This section of proposed regulation also stipulates that if a corporate's leverage ratio fell below 3% and it wanted to change its bylaws – presumably to enact a charter change – the NCUA could either conserve it or disallow a bylaw change. There may be other reasons to change bylaws while undercapitalized. If so, such necessary revisions could be blocked by the NCUA and thereby transfer governance of the institution from its owners to the NCUA.

Recommendation
Retain the old rule's flexibility of requiring corporates to submit a capital plan and requiring the agency to submit a capital directive. Let the circumstances of each instance guide the contents of those plans and corresponding regulatory actions. If the NCUA needs the power to conserve, isolate that power in the Federal Credit Union Act.

Impact to Natural Person Credit Unions
Natural person credit unions as owners and directors of a corporate credit union would be subject to having those rights of ownership and governance revoked because the proposed rule gives the NCUA broad powers to manage and govern it.

§704.6(c) and (d)
Concentration and Sector Limits Restrict Federal Funds Investing

Commentary
Federal Funds transactions are used to invest short-term liquidity. This is particularly important given the inter-month cash variability a corporate credit union typically experiences. Federal Funds transactions are not specifically excluded from the sector concentration limits, so paragraph (3) takes the effect of limiting aggregate Federal Funds transactions to the lower of 100% of capital or 5% of assets. This limit would severely restrict a corporate's access to the Federal Funds market. Paragraph (4) allows for an exemption to the concentration limit rules for deposits in other depository institutions but not specifically for Federal Funds transactions. Although Federal Funds transactions are nearly identical in practice to large wholesale deposits, they are considered sales and are not included in this exemption.

The limit on aggregate Federal Funds sales to a single obligor is 25% of capital. There are a limited number of counterparts that are bidding for Federal Funds at any one time in the marketplace. This limitation is too low given the inadequate number of counterparts bidding and will cause difficulty in managing a corporate's short-term liquidity position.

Recommendation
Change the definition of deposits to include Federal Funds or to change Section 704.6 (d) (4) to include Federal Funds transactions sold to other depository institutions in the exemption from concentration limits.

Change Section 704.6 (c) to allow a larger single obligor limit of 200% of capital on money market transactions with a term of 90 days or less. An alternative solution would be to specifically allow a single obligor limit of 200% of capital for Federal Funds transactions sold to other depository institutions.

Impact to Natural Person Credit Unions

Corporates will have difficulty investing ample short-term liquidity at reasonable rates, likely resulting in a reduction to the rates paid to their member credit unions on their overnight accounts.

§704.14(a)(3)
Six Year Term Limit for Directors

Commentary

The proposed rule establishes six year term limits for directors effective upon release of the new rule. The rule requires directors who will have served for six years to be replaced at the end of their current term. Additionally, the new rule does not allow for a representative from the same natural person credit union to serve as a director if the six year term limit is exceeded by another person affiliated with that entity.

This proposal further complicates development and retention of qualified board directors for corporate credit unions. In the short-term, this new provision will force corporate credit unions to replace a majority of board members when their current term expires. Since board members tend to be large depositors and to contribute capital commensurate with deposit levels, removing these directors will create a lapse of transparency between corporate credit unions and their largest users. The proposed rule's requirement that all directors be a CEO, CFO or COO of the member and that a majority be from natural person credit unions is sufficient safeguard from unqualified directors exerting undue influence on a corporate credit union.

A six year term is also shorter than the average business cycle. Corporate credit unions would lose the benefit of retaining directors who have experience in leading the organization through a complete business cycle.

Recommendation

Remove the six year term limit from the proposed rule.

Impact to Natural Person Credit Unions

The initial impact to natural person credit unions would be a turnover in current corporate credit union governance. Because many corporate credit union directors have served for six or more years, their directorships would not be extended when the current term expires. Approximately one-third to one-quarter of the available directorship terms expire each year, which would result in a 100% turnover of the board of directors during the three to four years following adoption of this final rule.

The directorship vetting process is already established through by-laws and generally involves open nominations and open polling during annual membership meetings. The ability of the process to supply corporate credit unions with qualified directors has been demonstrated. The proposed six year term limitation would systematically remove experienced, well qualified directors from the boards of directors at corporate credit unions. Inexpert directors, who are likely to be few in number, would also be removed but at great cost to the organization.