SkyOne
FEDERAL CREDIT UNION
The new name for FAA First

14600 Aviation Boulevard Hawthorne CA 90250
800.421.7111 www.SkyOne.org

March 8, 2010

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

Subject: Comments on Part 704 Corporate Credit Unions

Dear Ms. Rupp:

Thank you for 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.

SkyOne Federal Credit Union (previously named FAA First) is a $320 million credit union located in Hawthorne California. We serve 25,000 members who work in the air transportation industry. We have been members of WesCorp since 1981. Because of our long support of the corporate credit union system, we have a very strong interest in the proposed amendments to Part 704. We would like to see corporate credit unions continue in the future to help the credit union movement with payment systems, investment options and alternatives to more costly banking relationships.

We feel that there are several provisions that, if enacted as proposed, will make it essentially impossible for corporate credit unions to operate in a viable fashion. This is the time for NCUA to write regulations that will effectively manage risks, not eliminate risks. Further, many of these provisions will have harmful affects to natural person credit unions, and, ultimately, our members.

Our more critical concerns are drafted in this response in order of priority to SkyOne Federal Credit Union.

<u>1. Time Period for Capital Ratio Attainment</u>
As drafted, 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, member credit unions will likely be asked to contribute approximately 4% of the corporate credit union

1907

deposits as perpetual capital within 12 months of the publication date of the final rule.

With the amount of write downs SkyOne has already recorded ($1.2 million), we would be opposed to contributing this amount of capital in such a short period of time. We continue to keep some insured deposits and short term investments with WesCorp but we would be required to pull these deposits if such a ratio was required of WesCorp since we know this would be nearly impossible to attain. If most NPCU's did this, it would lead to liquidity concerns for corporates.

We recommend that NCUA extend the time period for attaining the risk based capital ratios to at least 3 years. This seems more reasonable in light of the current economic situation. This would give all natural person credit unions more time also to see how things improve in the economy and give the corporate credit unions the time needed to be within compliance. We agree with the League's urge that NCUA enact some kind of financing or capital note (equivalent to 4% of a corporate's balance sheet) to help corporates' meet their operational needs.

2. Retained Earnings Growth Model

We believe that the NCUA's assumption regarding a corporate's ability to grow retained earnings under the proposed investment and ALM limitations (pages 99-101 in the proposed rule), are unreasonable. The percentage allocated to Student Loan borrowing in the growth model and the spread to Libor are unsound and unrealistic. The combined 30% allocation is as concentrated as the percentage allocated in the model for overnight accounts. Yet student loans are an illiquid sector and fairly high risk. The income assumptions made under these balance sheet allocations therefore are also unrealistic. If this is the best asset allocation that can be put together to attain the growth and income numbers, then this speaks volumes that the expectation in this proposal cannot be attained.

Such a business model is unreasonable and counterproductive and, ultimately, will be crippling to the corporate network. For example, without an ability to generate earnings from investment risk, corporates will not be able to keep payment system fees down, forcing a move from a cooperative payment system to a for profit banking system. This will have a pronounced effect on natural person credit unions, as we will be saddled with much higher fees as well as the possibility of obtaining and maintaining new payment services relationships. We recommend that an alternative more realistic growth model be proposed along with more reasonable and attainable time guidelines.

3. Average-Life NEV Testing

The proposal requires average-life mismatch net economic value (NEV) modeling/stress testing, in addition to existing interest rate risk (IRR) NEV modeling, to include:

- A 300 basis point credit spread widening, coupled with a NEV ratio decline limited to 15 percent;
- A 50 percent slowdown in prepayment speeds to determine if the corporate has excessive extension risk; combined with
- A portfolio/asset limit of two years in average weighted life.

1908

We are very concerned with the proposed requirement of a two-year average life as this would reduce the earnings potential in these assets and therefore not allow corporates to generate sufficient interest margin to build retained earnings to meet the new capital requirements contained in the proposal. (The 2 year average weighted life limitation will make holding Agency and Private Label Mortgage Backed Securities—the largest sector of potential investments—virtually impossible for corporates.) Any ability to generate a reasonable interest margin in order to build retained earnings will become very dependent upon a lower cost of funds for corporates, which means a lower yield paid to us, natural person credit union members.

This provision limits the weighted average life (WAL) of a corporate credit union's aggregate assets to two years and includes loans to members. As stated above, we believe that a two year weighted average life requirement on assets would result in lower earnings and negatively impact any earning growth goals enacted for the corporate system. We recommend that a longer WAL measurement be enacted to allow the corporate system to meet earnings goals and still keep their balance sheet less risky. For example, we recommend a WAL of at least 5 years which we feel is more realistic than 2 years.

In addition, we recommend that that loans made to natural person credit unions be excluded from the calculation. Information made available to natural person credit union shows that historically over the past 15 years, excluding recent events, credit card and auto ABS credit spreads to LIBOR widened to a maximum of approximately 50 bps, and generated a standard deviation of spread volatility of approximately 10 bps. Based on this information, we also recommend a more realistic credit shock test of a 100 basis point widening which is double this historical average.

4. Premium for Early Withdrawals on Corporate Certificates

This proposed provision limits a corporate credit union's ability to pay a market-based redemption price to no more than par, thus eliminating the ability to pay a premium on early withdrawals. Such a change will pose a significant disincentive for us and will likely lead us to look for more competitive options elsewhere. The differentiating factor in corporate credit union investment options was the ability to redeem certificates early if we came upon cash constraints. As the person responsible for purchasing investments for two of my last credit unions, this was a huge factor in choosing to put money with Wescorp. Without this option, the playing field will only be based on yield, and based on the proposed regulation, corporate credit unions will not be making enough spread to offer its members that kind of advantage. We, therefore, recommend that this proposal be removed from the final rule as it is not only counterproductive to maintaining corporate liquidity and natural credit union investment options, but would likely have long-lasting and harmful effects to the system.

5. Perpetual Contributed Capital

SkyOne FCU supports eliminating the current prohibition on a corporate requiring credit unions to contribute capital to obtain membership or receive services. We feel that it would be a benefit for a corporate credit union to be allowed to choose whether they want to require a capital contribution from a natural person credit union or not. Many natural person credit unions, including SkyOne FCU remain wary of putting in additional capital contributions when we have no idea what the

1909

future of corporate credit unions is. We recently wrote off $1.2 million in capital contributions made to WesCorp. We are in no position to make additional capital contributions with the future of corporates hanging in the balance.

6. Payment of Dividends
We are opposed to this portion of the proposal that will prohibit an undercapitalized corporate, unless it obtains NCUA's prior written approval, from paying dividends on capital accounts. If the goal of this restructuring proposal is to get corporate credit unions recapitalized and functioning in their role to provide service to natural person credit unions, then how can a proposal that will keep NPCs from contributing capital to them make sense? We have all learned how risky capital accounts are. We cannot accept risk without some form of reward. To balance that higher risk, we will be reluctant to contribute capital without the promise of a higher return to compensate for the added risk. We recommend that instead of this proposal, NCUA should consider a retained earnings target for corporate credit unions. This will have the same result as the board and management of a corporate credit union would restrain from paying dividends if they are below the minimum earnings target. This recommendation is more palatable as it reduces the bureaucracy of added paperwork that asking for permission would require.

To summarize, SkyOne Federal Credit Union firmly believes that changes should be made to the proposed amendments to Part 704. As we have listed above, we have concerns with many of the items specifically regarding the viability and reasonableness of the tests and the two year average weighted life limitation, as well as the capital ratio attainment and the retained earnings growth assumptions. More analysis is needed on whether historical trends justify the proposed tests and thresholds. Added regulations and limiting guidelines will not fix the current issues at hand. Let's work together in writing a revised regulation that effectively manages risk instead of attempting to eliminate risks. We are in trying times and we do not want the failure or elimination of our corporate credit union system, which we have all relied on for so many years. Our doubts and concerns regarding these proposed provisions are further amplified when we consider that NCUA may choose to incorporate them into planned revisions to Part 703, which will have similar, debilitating effects on natural person credit unions.

Thank you for your consideration.

Sincerely

Eileen Rivera

Eileen Rivera
President/CEO

19