

**From:** [Rutan, Charles](#)  
**To:** [Regulatory Comments](#)  
**Subject:** Comments Regarding Proposed Regulation 12 CFR Part 704  
**Date:** Monday, March 08, 2010 3:28:50 PM

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March 8, 2010

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

Re: Proposed Regulation 12 CFR Part 704

Dear Ms. Rupp:

The NCUA Board has proposed a regulation that will significantly impact the nation's corporate credit unions. The NCUA's objectives are commendable and understandable as we are proceeding through some very difficult economic times. However, the impact of the restrictions within the regulation, when taken as a whole, raise serious doubts about the ability of corporate credit unions, and in fact the entire corporate network, to exist in the future. And even though this regulation is directed toward the corporate system, I believe that it will ultimately have a great impact on Natural Person Credit Unions.

While all NPCUs will likely be faced with lower yields on deposits and increased fees, I also fear that the blunt of the impact will be felt by small and medium size NPCUs that depend heavily upon the services offered by the corporate system for their survival. These credit unions have fewer options and a very limited ability to negotiate prices. While currently 95% of all NPCUs use the corporate network, the result of this regulation might well be that NPCUs are forced to return to buying their products and services from providers that are not part of the cooperative system. It would be a sad day for the credit union movement if that were to occur.

I would like to comment on some major limitations in the proposed rule that cause me a number of concerns, and if not amended, the limitations being proposed may force my credit union into the position of seeking an alternative, possibly more costly provider instead of a corporate credit union.

Here are my primary concerns:

#### **704.2 Definitions**

The new regulation requires member-contributed capital accounts to be depleted when needed to cover corporate credit union losses. The environment at the time that NPCU's were initially asked to comment on the proposed regulation was one where billions of dollars were being assessed these NPCU's and executives fully expected the mortgage backed securities that caused the losses would be held to maturity. We have learned at recent Town Hall meetings that there is a plan for removing the MBS from the Corporates balance sheets so that each of them gets a "clean" start. I believe that this significantly alters the context under which the new regulation that is being considered and, as such, finalization of the regulation should be delayed until the NCUA discloses such plans **and** NPCU's have a chance to comment on them.

Regardless of whether or not the final resolution of the plan is to restart the Corporates with a "clean balance sheet", I believe that NCUA should either not require depletion of NPCU contributed capital based on **projected** losses or at minimum, let corporate credit unions maintain a retained earnings deficit. Under the proposed regulation depleted funds may not be restored if projected losses ultimately overstate actual losses. To support this I would point out that at least one corporate credit union has proven to the NCUA that GAAP does not require extinguishment, only the recording of the loss. If the NCUA proceeds with requiring extinguishment, Corporates will not be able to recognize increases in value should these securities recover or return the capital to NPCUs.

### **704.3 Corporate Capital Requirements**

In order for a credit union to be willing to re-capitalize the corporate credit union network, it is imperative that the NCUA isolate new member contributed capital from potential future impairment losses relating to legacy assets. This will help the future capitalization of corporate credit unions. If future capitalization of the corporate credit union is at an *immediate* risk of being written down due to losses sustained from legacy assets, there is no incentive to remain with the corporate credit union network to conduct business.

### **704.8 (c) Penalty for early withdrawals on corporate certificates**

The proposed rule establishes a penalty for early withdrawals on corporate certificates. The logic for this requirement would appear to be to try and prohibit NPCUs from withdrawing funds should they again encounter a crisis similar to the most recent one. But the unintended result will likely be that NPCUs will look outside the system for their investments. As written the proposed regulation would eliminate Corporates ability to pay a premium on certificate withdrawals even if rates were falling and the redemption price was above par.

I would suggest eliminating this proposal and the current rule for certificate redemptions which require the corporate credit unions to assess a market-based penalty sufficient to cover the estimated replacement cost of the certificate redeemed remain in place. Credit Unions needing liquidity should be able to obtain a premium on certificate redemption if market conditions allow for it. If the proposed rule is not eliminated or modified, I believe that all but the smallest NPCUs will look outside the system for longer term, liquid investments that do not punish them for early withdrawals. This ultimately could significantly impact the deposit structure of Corporates which in turn impacts their ability to provide lines of credit.

### **704.8 (d), (e), & (f) NEV sensitivity analyses**

The corporate credit unions that have been allowed to make public comments all express that the proposed limitations placed on a corporate through various NEV tests does not allow them to generate sufficient interest margin to build retain earnings to meet the proposed capital requirements. Therefore one can expect that NPCUs will be faced with higher fees and that Corporates will have to reduce expenses also leading to an adverse impact on the service NPCUs receive.

I recommend NCUA strongly consider the recommended rule changes for section 704.8 as submitted by a number of corporate credit unions. The corporate credit unions have a great understanding of the impact the current proposed regulation will have on them and need to be allowed the enough flexibility in their balance sheet to not only grow but to invest in innovation that will benefit member credit unions.

### **704.19 Disclosure of Executive and Director Compensation**

The proposal to require disclosure of "the compensation of each senior executive officer and director" is, in my opinion, too strict. While I understand the mood of Washington, DC to be more transparent, corporate credit unions are not publicly traded companies and I do not see the benefit to holding them to the standards of public institutions when it comes to compensation disclosures. In fact I believe that this rule could make it very difficult to recruit externally qualified candidates as they will give priority to jobs where their salaries and benefits are not in the public domain. And this provision also begs the question – how will this requirement reduce the overall risk at the corporate credit union?

I would urge reconsideration of this section of the proposal with support for eliminating it altogether. If the NCUA feel compelled to disclosed compensation and benefits, it should be limited to the Chief Executive Officer and those reporting directly to the CEO or simply the top three earners at the corporate.

### **704.6 (c) & (d) Concentration Limits**

The current proposal for concentration limits appears to make it difficult for Corporates to invest short-term liquidity at a reasonable rate. The limits are too small, too restrictive and the impact will be to reduce the overnight rates that NPCUs receive from their Corporates at a time when it is most needed. One recommendation would be to change the definition of deposits in 704.6 (d) to include Federal Funds or exempt Federal Funds from sector concentration limits. I would also urge you to consider increasing the single obligor limit to 200% of capital on money market transactions with a term of 90

days or less in section 704.6 (c).

**704.8 (k) Limit on Business Generated from individual Credit Unions**

Under 704.8 (k) a corporate would be prohibited from having a single member or entity make up more than 10 percent of its moving daily average net assets. I understand having a limit. But I believe that the proposed 10% cap may limit the Corporates options when it comes to short-term borrowings resulting in them receiving less favorable terms. This would also negatively impact the corporate earnings by forcing them to maintain larger cash balances

I would propose revising the limit to 20% or including an exemption provision for the Federal Reserve, a Federal Home Loan Bank, a Repurchase Agreement counterpart or a Federal Funds counterpart by eliminating the clause "or other entities."

**General Concern**

One significant overall concern with the proposed regulation is what appears to be imprudent assumptions in the model the NCUA used. The purpose of the model was to prove that a corporate can in fact, grow retained earnings at or above 20 bp a year and therefore achieve income from operations sufficient to build the 100 bp of retained earnings in 5-6 years. I understand that the assumptions have been challenged in a document drafted by the Association of Corporate Credit Unions which takes the NCUA model from making a profit to generating an annual loss. While I do not feel qualified to comment on the specific assumptions, it is a concern to me that overall the corporate network does not feel the assumptions are valid.

**Summary**

The above areas comprise my major concerns with NCUA's proposed rule and I hope that the current proposal will be reconsidered with thought taken to the issues presented in this response as well as other issues submitted by corporate credit unions and other natural person credit unions.

I want to see the corporate restructure work in a manner that benefits the credit union industry and allows the corporate credit union network to be of value to all credit unions. I hope that my comments along with others will assist with that process.

Respectfully,

Chuck Rutan  
President/CEO  
Southwest Airlines Federal Credit Union  
Dallas, Texas