From:	Steve Sanborn
To:	_Regulatory Comments
Subject:	WELD SCHOOLS CREDIT UNION Comments on Part 704 Corporate Credit Unions
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March 8, 2010

Dear NCUA Board of Directors:

In the February, 2010, issue of *The NCUA Report*, the lead article gives a corporate credit program update. The article ends as follows:

> …t*he ultimate resolution of corporate credit union problems will not occur without the support of member credit unions. Corporate credit unions must evaluate their business model, operating structure, and service array against the proposed requirements of the new regulation to find the best medium to achieve continued viability.*

This statement is reasonable if Regulation 704 changes allowed corporate credit unions to operate with a business model that will succeed. The opposite appears to be the case.

Analysis by corporate credit unions is showing that after careful review and detailed modeling of both existing balance sheets and new start-up corporate balance sheets (with no legacy assets), corporates are concluding that they will be unable to develop an actionable business model that meets the requirements of the proposed regulation for capital growth.

After working 30 years in the credit union movement, I am alarmed over the unintended consequences of what is being proposed and how it will devastate our industry. It appears that the destruction of the corporate credit union system is inevitable if the current Proposed Changes are enacted. From the trenches I can report that 'the vultures are circling the carcass.' I am already being approached by vendors offering services to replace those that we now receive from the corporate credit union we use. In addition I have yet to talk to one credit union manager who is not setting up accounts with the Federal Reserve in anticipation of the failure of the corporate credit union system because of the Proposed Changes as outlined.

The above is occurring because there are unintended consequences in Proposed Changes to 12 C.F.R. Part 704 which will impact a corporate credit union from succeeding. Two main areas need addressed: the average life requirement and the credit shock test. Without modification, credit union's will see:

- significantly higher fees for products and services. So high, in fact, that the services will force credit unions back to non-cooperative solutions. After three decades, credit unions will once again have to go back to using bank services, the very competition who oppose us.

lower rates on investments (corporate credit unions are estimating 20-25 basis boints) will cost member credit unions between $18 and $23 million in lost income annually based on

2009 year-end balances. Coupled with other restrictions in the Proposed Changes, these offerings would generally be uncompetitive and unacceptable to credit unions.

- term lending by corporate credit unions will need to be significantly curtained or abandoned.

- All of this is happening at a time when credit unions can least afford more hits to their bottom lines as we struggle through the worst recession in decades.

Pages 99-101 of the Proposed Changes detail the business model which appears to be unrealistic. Specifically:

- No cost of capital – members will not contribute additional capital without a credit premium.

- Extremely high-yielding, single asset class concentration (private student loans ABS). The proposed levels of investment in this asset class are beyond prudent levels.

  Also, the private student loan sector is not deep enough to support aggregate corporate demand. Given the lack of depth of this segment, it is likely that corporates would bid these assets higher which in turn will substantially reduce the yield. In your sample model, this relatively small segment of investments is projected to produce almost 60% of project corporate income. How can this be possible?!

- Legacy assets are ignored. Corporate that have OTTI on their books still have adjustments to net interest income going forward that equals about 10 basis points thereby making it impossible to meet the new capital requirements. *Members will not re-capitalize corporates if they continue to be exposed to losses from these assets.*

NCUA should make the following key changes in the Proposed Regulation:

- Drop the average-life requirement while maintaining the 300 basis point credit shock test ensuring strong risk management.

- Provide credit for core deposits in the credit shock test. This will more accurately assess risk in this stressed scenario.

Both of these changes are needed to avoid jeopardizing the viability of corporate credit unions and ultimately the operating environment of many in the credit union system.

Other key concerns:

Indemnity. The Proposed Regulation prevents indemnity in some cases. While the intent is to prevent indemnification against regulatory actions, the language is fairly broad and exposes volunteer directors and management to unlimited personal risk. What this means to credit unions is that it may be difficult to find and retain volunteers and management. Quality leadership will be critical in the future and this may cause many capable leaders not to participate.

Certificate Redemption. The Proposed Changes prevent redeeming certificates at a premium. Where the intent is to protect liquidity, this will have a significant negative effect in the marketplace. Corporate certificates will *de facto* be less liquid than other providers. Unless yield is adjusted (i.e.corporates pay more), member credit unions will take their business elsewhere. This would essentially weaken certificates offered to members of corporate credit unions, increase corporate costs and hamper their liquidity.

Regulatory Authority. Where it is critical that the regulator has sufficient authority to manage, supervise and control corporate credit unions, the Proposed Changes vest an untenable level of regulatory control with little oversight, no required documentation and no objective appeal process. NCUA will have the ability to subjectively change minimum capital requirements for virtually any reason. In addition, NCUA will have the ability to subjectively change the application of rules and regulations without appropriate due process. Should changes to regulations be necessary, due to new financial instruments or strategies, the NCUA Board should make amendments to the regulation through the current regulatory approval process.

At a minimum, NCUA Board approval should be required to reassess capital level requirements or regulatory rating changes at corporate credit unions. Both the reduction of capital rating and the basis for the reduction (ex. declines in a single CRIS-rating category) are subjective decisions made by NCUA. The NCUA already has sufficient regulatory tools to enforce compliance with safe and sound operating practices without this complex and, what could conceivably become, arbitrary process. Rather, an appeal mechanism needs to be developed to support an objective process. Authority to exercise these regulatory prerogatives should be tightened significantly. It is also recommended that the NCUA Board approve any such change in capital requirements only with a) appropriate documentation of risk, and b) the opportunity for the corporate credit union to offer explanatory evidence.

Governance and Board Limits. Where it is critical to maintain qualified representation from member credit unions to serve on corporate boards, setting term limits does not ensure a well-qualified and diverse board – only a new board.

It is more important to charge a corporate's nominating committee with the responsibility for establishing detailed criteria for the expertise of board members. Setting 6-year term limits as proposed will require the entire board to turn over every 6 years. While term limits are appropriate, a rapid turnover of volunteers who direct and oversee the operations of financial institutions like corporates would be detrimental. Term limits this short will only guarantee the loss of institutional intelligence. A new board member would not be able to gain the wider breadth of experience that another board member, who has been through several business cycles at the corporate, would possess. Term limits should be expanded to 9-12 years from the proposed 6-year timeframe. Board membership will benefit from "new blood" while maintaining the organizational history of the corporate. An unstable or inexperienced board should pose a safety-and-soundness concern for the regulator.

The NCUA Board it to be commended on its efforts to strengthen the credit union system, but vital changes to the Proposed Changes of Regulation 704 are truly needed. Thank you for considering the changes recommended above. Please extend the period of time before enactment of the changes to allow more time for analysis and exploration of solutions to these complex problems.

Sincerely,

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