March 8, 2010

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

Dear Ms. Rupp,

Fairfax County Federal Credit Union (FCFCU) appreciates the opportunity to comment on the NCUA's proposed Regulation Part 704 concerning the role of the Corporate Credit Union Network and its structure. As background, FCFCU is a $225 million natural person credit union that has served the financial needs of over 18,000 members that live, work or worship in Fairfax County, Virginia. As a conservatively run, member-owned cooperative we have always tried to support similar types of cooperative businesses whenever possible. To that end, we have used many services offered through our corporate credit union, VACORP. According to the research I have done, VACORP had not engage in many of the practices that this new regulation is trying to curtail. I believe some of the proposed changes are appropriate and may lead to improvements in the corporate system; however if the changes to Part 704 are implemented as proposed without modification, they will significantly restrict the ability of VACORP to continue providing essential services to FCFCU and to other similar sized credit unions. Restricting corporate credit unions to the point that they are uncompetitive in the market will drive credit unions to non-movement, non-cooperative based providers. The resulting move to alternative investment products or service providers will present an additional burden on NCUA to ensure that these providers do not represent an exposure to the very risks the NCUA is trying to eliminate within the corporate network. Finally, as some of the comments that follow indicate, many of the proposed changes seem to be reactionary to a particular set of financial problems that no one yet fully understands. In short, the proposed rules are being proposed before anyone is able to determine what the root cause of the financial problems the rules are trying to address, what the effect other market forces will have on the existing corporate and natural credit unions and how a host of other government programs will interact with these rule changes.

Below, I have outlined some of the important considerations that I believe need to be addressed before the regulation is finalized.

Regulation 704 – Major Challenges

1. Missing critical information
2. Proposed business model
3. Board governance and term limits
4. Penalty for early withdrawal
5. Corporate CUSO restrictions
6. Prohibition of replenishing membership capital
7. Time period for capital ratio attainment

8. Disclosure of executive compensation for all staff above a Vice President level
9. Prohibition of providing indemnification to corporate directors and management
10. 10% deposit concentration limit

1. **Missing critical information**: While the comment period for the proposed regulation has a deadline of March 9, 2010, credit unions still do not have the most important information. What are the total losses going to be? NCUA now estimates $4 billion to $6 billion in anticipated investment losses. The original estimate was as much as $11 billion and $6 billion has already been earmarked. With housing recovering in some of the nation's hardest hit areas, will those losses actually be realized?

   What role will "legacy assets" play in corporate restructuring? Will new capital depositors be at risk if further losses occur on the legacy assets – greater than the $6 billion estimate? NCUA's Office of Corporate Credit Unions Director Scott Hunt has said by the time the proposed changes were implemented, all corporate balance sheets will be cleansed of other than temporary impaired (OTTI) and legacy assets. This significantly alters the context under which these proposed rules should be considered.

   Recommendation:
   What role will legacy assets play? This critical issue should be resolved before revamping the regulation and the entire corporate network. The comment period should be extended, until after the NCUA discloses legacy asset plans for the corporate system. Alternately, the NCUA could provide a comment period on the proposed plan for legacy assets prior to the issuance of the final rule.

2. **Proposed business model**: There is a great deal of disagreement regarding the viability of the corporate business model as outlined. It is important to know the outcome of NCUA's third-party consulting firm's study of the agency's projections and the impact on their corporate plan. Without getting into the details of the NEV analysis, credit risk shocks and weighted average life restrictions on investments, it appears that most corporate credit unions seemed to have concluded the new restrictions would not allow them to be viable. While investment risk would be eliminated, so would any chance of attaining sufficient profitability to build reserves to required levels within the time frames outlined in the proposed rule.

   Recommendation: **Along with several other issues, the new NEV tests, two-year weighted average life investment limitation and cash flow mismatch constraints need to be amended. NCUA's pro forma analysis ignores the costs of raising capital, adjustments for inflation, and assumes historically high spread yields on a portfolio that is over-weighted with student loan assets. Credit unions should be allowed to analyze the outcome of the consultant's report before NCUA asks for final comments.**

3. **Board governance & term limits**: As a strong believer in the cooperative model, I do not believe that limiting potential board candidates to CEO, CFO and COO titles is an effective measure for identifying qualified candidates. This standard could arbitrarily include candidates with limited experience in a credit union while excluding more qualified professionals or volunteers. Additionally, the proposed six-year term limit would be a detriment to board governance and a direct contravention of the democratic cooperative principles that the credit union movement has been based.

These infringements on cooperative principles of self determination and limitations on service longevity are without any subsequent benefit to the organization other than to encourage the entrenchment of a management cadre that may not always act in the members' best interest.

<u>Recommendation:</u>
The corporate credit unions' nominating committee should establish qualifications for corporate board members that focus on experience and knowledge of credit union financial systems as criteria and do not limit candidates solely based on prior participation in areas to which they are applying.

4. **Penalty for early withdrawal**: One of the more perplexing changes to the regulation is the change which prohibits a corporate from redeeming credit union certificates at a premium. Currently, a corporate may redeem an outstanding certificate at a market rate – even if it is at a premium dollar price. The proposed regulation eliminates that possibility. This will place corporate credit unions at a significant funding disadvantage and would likely eliminate the possibility of issuing certificates. Credit unions would have little choice but to look outside the corporate system for longer-term liquid instruments, which would not punish them for early redemptions.

   <u>Recommendation:</u>
   This proposal should be removed in its entirety.

5. **Corporate CUSO restrictions**: Credit union collaboration is an essential part of the credit union cooperative system. Using the corporate for settlement activity, lines of credit, etc. is a natural extension of our cooperative movement. Under the proposed regulation, Corporate CUSO involvement is restricted to "categories of services approved in writing by the NCUA." The provision also allows NCUA free access to books, records, and operations of the CUSO, further discouraging credit unions from involving corporate credit unions in any cooperative endeavors.

   As far as permissible activities, the proposed regulation identifies only two approved services for a corporate CUSO – brokerage and investment advisory services. NCUA is aware of the range of CUSOs in which corporate credit unions currently have investments. I would recommend that NCUA add those services to the approved list of CUSO services for corporate CUSOs. If not, what criteria will NCUA use to determine appropriate services for a corporate CUSO? I believe the control of this decision should remain with a corporate and its members.

   <u>Recommendation:</u>
   No restrictions should be placed on CUSOs where the corporate does not have a controlling interest. All previously approved corporate CUSOs should be added to the NCUA's approved list of CUSO services for corporate credit unions.

6. **Prohibition on replenishing membership capital:** Since the shareholders (usually natural person credit unions) of a corporate credit union took the economic risk of investing in their corporate, they should have the right to any eventual gain on depleted assets. I am very concerned with the regulatory

mandate to permanently deplete capital based solely on estimated losses created by an OTTI model in a manner that allows no possibility for corporate credit unions to replenish capital back to existing shareholders if actual losses are less than projected. GAAP does not require this treatment being applied by NCUA.

<u>Recommendation:</u>
NCUA should not require permanent depletion of capital based on estimated OTTI model predictions and should allow for a mechanism to exist where by corporate credit unions would be able to replenish capital back to existing shareholders if actual losses are less than projected.

7. **Time period for capital ratio attainment:** The proposed rule would give corporate credit unions three years to achieve a 4% leverage ratio, with specific one year and three year benchmarks. Most corporate credit unions have little or no retained earnings and only three-year notice Membership Share Accounts (MCA). Thus, to comply with the 4% ratio requirement of year three, a majority of corporate credit unions will need to convert shares in their MCAs to the new Non-perpetual Capital Account (NCA) and/or Perpetual Contributed Capital (PCC), as well as ask members to contribute substantial additional perpetual capital. This rush to achieve a 4% Leverage Ratio via PCC may result in unintended consequences if natural person credit unions resist participating in a plan requiring decisions to be made within such a short time frame.

   <u>Recommendation:</u>
   The NCUA should extend the time period for attaining the 4% leverage ratio from three years to five years.

8. **Disclosure of executive compensation for all staff above a Vice President level**
   The ability of corporate credit unions to recruit, recognize and retain talented, committed senior executive officers is important. Corporate credit unions should have reasonable flexibility in formulating senior executive compensation arrangements to ensure a stable and competent senior leadership team.

   Corporate credit unions should also be allowed to choose the format for disclosing executive and director compensation that they consider most appropriate. The new regulation should identify the categories of compensation that must be used, so that corporate credit unions are reporting the information in a consistent manner.

   FCFCU agrees that executive compensation arrangements, with respect to mergers involving corporate credit unions should be transparent. A material increase in compensation for any senior executive officer or director must be included in merger plan documents submitted to NCUA, and disclosed to the membership (of federally chartered corporate credit unions) prior to members voting on the merger. This disclosure should include merger-related compensation extended to the officers and directors of both the continuing credit union and the merging credit union.

   <u>Recommendation:</u>
   Corporate credit unions should be allowed to choose the format for disclosing executive and director compensation that they consider most appropriate.

9. **Prohibition on providing indemnification to corporate directors and management**
   This proposed change 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.

   Recommendation:
   Continue to allow corporate credit unions to provide, at their discretion, indemnification coverage for directors and management for actions taken while fulfilling their duties that are not addressed by insurances.

10. **10% deposit concentration limit**
   The proposed change will drain liquidity from the system by forcing credit unions to place funds outside of the corporate system. This will result in less efficient deposit processes and, quite possibly, larger risks for each credit union as well as the entire cooperative credit union system. This proposed limitation places further regulatory constraints on corporate credit unions that no other regulated financial institutions are required to follow. New regulatory restrictions, coupled with the capital standards that corporate credit unions will be required to achieve, will make it very difficult for corporate credit unions to compete in the financial services marketplace. Current regulation allow credit unions to choose to invest an unlimited amount of funds in banks, as long as proper due diligence is conducted. The same credit unions 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 assessment of the value and risk they want to assume and an arbitrary limit placed on corporate credit unions should not be put into effect. Alternatively, limit deposits from one source to 10% of a corporate credit union's assets or to 100% of a corporate credit union's assets which carry a 20% risk weighting, whichever is greater.

Cooperatively organized corporate credit unions are a critical component of the credit union movement. They offer a uniquely supportive role in helping many credit unions to survive, compete, and thrive in a highly competitive marketplace. FCFCU is supportive of NCUA's efforts to improve Regulation Part 704, but is extremely concerned that in an effort to make that improvement, NCUA has incorporated change that will instead impede corporate credit unions from fulfilling their vital role of assisting credit unions serve their members in a democratically and cooperatively based manner. I believe the recommendations suggested will help relieve that impediment.

Please feel free to contact me at jthomas@fairfaxcu.org or at 703.218.9900 x1130 if you have any questions concerning our comments.

Sincerely,

Joseph D. Thomas, Jr.
President/CEO