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AMERICA'S CREDIT UNIONS

March 9, 2010

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

Re: Proposed Corporate Credit Union Regulation 704

Dear Ms. Rupp:

On behalf of the management and Board of Wickliffe Paper Mill Federal Credit Union, I would like to take this opportunity to express our appreciation to the NCUA Board for allowing us to comment on the proposed corporate credit union Regulation 704.

Wickliffe Paper Mill Federal Credit Union is $7 million in assets, has 745 members, and serves NewPage and MeadWestvaco employees and immediately family members in Wickliffe KY and are currently members of Kentucky Corporate FCU.

While the proposed NCUA Regulation Part 704 contains some beneficial changes that will reduce risk and augment the value of corporate credit unions going forward (i.e. stronger capital standards, limits on investment concentrations, prohibitions on certain securities, and enhanced liquidity processes), the proposed rule contains several changes which, left unchanged in the final rule, will significantly limit the value that corporates will be able to provide and therefore are not in the best interests of the credit union system.

<u>704.2 Definitions</u> – *<u>Available to cover losses that exceed retained earnings</u>*
To the extent that any contributed capital funds are used to cover losses, the corporate credit union must not restore or replenish the affected capital accounts under any circumstances.

We are confused with the rationale for this definition. If the intent of this definition is not to reduce the capital level of a corporate credit union then this could be achieved by adding the phrase, "until a corporate credit union meets the well-capitalized level and any return of capital will not lower the corporate capital below the well-capitalized level" following this sentence. If the agency's concern is safety and soundness, once these capital levels are met, there will no longer be a safety and soundness issue.

Additionally, the regulatory mandate, to permanently deplete capital based on estimated

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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, is a major concern. 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 likely that the FASB will change the credit impairment model standards in 2010 to allow OTTI reversals 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.

<u>704.3 Corporate credit union capital</u>

Effective [12 MONTHS AFTER DATE OF PUBLICATION OF FINAL RULE IN THE FEDERAL REGISTER], revise §704.3 to read as follows:

(a) *Capital requirements.* (1) A corporate credit union must maintain at all times:

(i) A leverage ratio of 4.0 percent or greater;

(ii) A Tier 1 risk-based capital ratio of 4.0 percent or greater; and

We are also confused by this section of the regulation. We have been told in several of your town hall meetings that the "leverage ratio" would not become effective until 36 months after the final rule has been published. However, in this section of the regulation (pages 152 and 153), it states that this part of the regulation would become effective 12 months after the final rule has been published. We ask that you make regulation to reflect the 36 month time frame, as it continues to be communicated to all credit unions by you, the NCUA.

In addition to the leverage ratio, we ask the NCUA to make the effective date of the Tier 1 risk-based capital ratio 36 months, the same as the leverage ratio. To require corporates to bring in new capital or at a minimum convert existing MCA to the new PCC could be difficult during a time when significant issues still remain with regards to legacy assets for some corporates. Raising contributing capital in such a short time frame will be challenging until corporate credit unions can demonstrate their business model will succeed under the revised regulation 704. Since it will be necessary to raise PCC for both the leverage ratio and the Tier 1 risk-based ratios, it makes sense to extend the effective date of both ratios to 36 months.

<u>704.14. Representation</u>

(3) No individual may be elected to the board if, at the expiration of the term to which the individual is seeking election, the individual will have served as a director for more than six consecutive years.

We feel the 6 year term limitation is too restrictive. It typically takes several years for a board member to receive adequate training and to fully understand the operations of a corporate credit union. Once the six year term limit is instituted, there will be very little institutional knowledge on a Board with these limitations. Once a board member becomes knowledgeable of all corporate functions, they will be forced to step down. If the NCUA is determined to institute a term limit, a nine year term limit would be more practical.

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704.8(h) Two-year average life

(h) Weighted average asset life. The weighted average life (WAL) of a corporate credit union's investment portfolio, excluding derivative contracts and equity investments, may not exceed 2 years.

The impact of this part of the proposed regulation negatively effects a corporate credit union's ability to earn an adequate yield on its investment portfolio. One way a corporate credit union adds yield to its portfolio is to move out the maturity spectrum. Securities with longer maturities or weighted average lives typically earn higher yields to compensate investors for the additional interest rate risk inherent in the longer term. The current NEV testing required of corporate credit unions adequately measures and limits this risk. This WAL restriction will lower the yield a corporate credit union will be able to earn on its portfolio and will lead to lower rates available to natural person credit unions on corporate credit union certificates. We might note that this will be a significant competitive disadvantage to the banking industry; credit unions will be much more restricted in their investing choices than other deposit takers in the US economy.

A second effect from this part of the proposed regulation will be on the asset mix of a corporate credit union's investment portfolio. This weighted average life limit will make it very difficult for a corporate credit union to invest in agency mortgage-backed securities (MBS). While we realize MBS are the cause of the corporate losses, it was the private issue, non-agency mortgages that were the problem. Agency MBS are highly liquid instruments that can be easily sold if liquidity is needed. Unlike non-agency MBS, agency pass through securities have very low credit risk and pose very little risk to a widening of credit spreads. There are very active and liquid markets for borrowing using agency MBS as collateral should liquidity needs arise. Had U.S. Central or other corporates bought agency MBS, my credit union would not be experiencing large insurance premiums or writing off our capital at my corporate. Agency MBS, used properly, are a prudent investment alternative for corporate credit unions.

We urge you to amend this section to allow a weighted average life of 3 years and that Agency and government-guaranteed securities be treated separately with a longer weighted average life restriction of 5 years.

Ability to grow retained earnings under the 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. This capital should be well above market rates thus causing lower net income than reported in the NCUA's example. The assumptions on spreads and other factors appear to be unreasonable or unachievable. We ask that you review the example provided and verify with outside sources to ensure these regulations allow for a viable business model for corporate credit unions.

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704.8(k) Deposit Concentrations

(k) Overall limit on business generated from individual credit unions. On or after [30 MONTHS AFTER DATE OF PUBLICATION OF FINAL RULE IN THE FEDERAL REGISTER], a corporate credit union is prohibited from accepting from a member or other entity any investment, including shares, loans, PCC, or NCAs if, following that investment, the aggregate of all investments from that member or entity in the corporate would exceed 10 percent of the corporate credit union's moving daily average net assets.

The stated objective for limiting deposits from any one source to no more than ten percent of a corporate's assets is to reduce risks that arise from placing undue reliance on a single entity. However, by limiting funds from any one source to no greater than ten percent of a corporate's assets, the proposed regulation would:

1. force funds out of the credit union system
2. penalize corporates that acted responsibly with their members money
3. deny credit unions their ability to invest in institutions they deem appropriate

If this limit is imposed, the likely scenario going forward is that the credit unions will withdraw funds from the system. This not only decreases the liquidity in the network (possibly leading to the forced sale of distressed securities currently held by U.S. Central and other corporates), but also the overall decreased liquidity in the system may result in the restriction of credit some credit unions would otherwise provide to their own members.

A credit union can choose to invest an unlimited amount of funds in a bank if they conduct proper due diligence. Why, then, should they be precluded from investing the same funds in another credit union (corporate or otherwise) if they conduct the same due diligence? There are many credit unions that are extremely glad that their money was invested in certain corporates. If the proposed ten percent limit had been in place prior to this crisis, those credit unions could have lost money unnecessarily by virtue of them being forced to make deposits into other institutions or other investment options. A credit union should have the right to choose into which financial institutions it places its money... and its trust.

This part of the regulation should be removed.

704.8. Asset and liability management

(c) Penalty for early withdrawals. A corporate credit union that permits early share certificate withdrawals must redeem at the lesser of book value plus accrued dividends or the value based on a market-based penalty sufficient to cover the estimated replacement cost of the certificate redeemed. This means the minimum penalty must be reasonably related to the rate that the corporate credit union would be required to offer to attract funds for a similar term with similar characteristics.

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This section of the regulation removes the ability of a Corporate to redeeming an outstanding certificate at the market rate for a credit union, even if it is at a premium dollar price.

The apparent intent of this section is to remove a credit unions' motivation to withdraw funds prior to maturity—as many did during the current crisis. Currently, a credit union can redeem one of its corporate certificates, even if the redemption price, due to falling rates, is above par. This proposed rule would penalize early withdrawals and eliminate the Corporates' ability to pay a premium on early withdrawals. 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. We ask that NCUA leave the current rule in place; removing this section from the final regulation.

Legacy Assets

This regulation does nothing to address the legacy assets (non performing investments) that U.S. Central and some corporates hold on their books today, but require new capital to be raised by members in order to stay in business. Corporate's future is clearly in the hands of the NCUA for many years to come because of the new capital standards and the new PCA requirements. To those Credit Unions willing to further capitalize the Corporate in the near future, this is not a comfortable position for Corporates or existing members. NCUA's delay in detailing their plans for these "legacy assets" causes a corporate to defer any decisions or plans to move forward until this is resolved. These delays could cause issues for our corporate to meet the several capital goals in the near future, as mandated by the regulation.

Conclusion

There are a number of good proposals in these regulations in its current state, including: raising the capital requirements for entities with higher investment risks; reducing the use of short-term funding to finance longer term assets; and improving portfolio diversification. These provisions should remain.

However, there are also serious issues that must be addressed, as listed above. Any one of these new rules on its own would cause a major change to the operations of my corporate credit union which may threaten its very existence. Please consider my comments carefully to ensure a safe and sound corporate credit union, while providing our credit union with the financial services necessary to survive.

Again, thank you for providing us with the opportunity to respond to the proposed regulation.

Sincerely,

Paula Beardsley

Paula Beardsley
Manager

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