From: Chris Coursen
To: _Regulatory Comments
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Subject: Comments on Part 704 Corporate Credit Unions
Date: Tuesday, March 09, 2010 9:23:03 PM

Date: 03/09/2010

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

Subject: Comments on Part 704 Corporate Credit Unions

Dear Ms. Rupp:

On behalf of Fairview EFCU, I appreciate 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.

Our comments are organized as follows:

1. Time Period for Capital Ratio Attainment
2. Retained Earnings Growth Model
3. Average-Life NEV Testing
4. Weighted Average Asset Life
5. Legacy Assets
6. Qualifications of Directors
7. Risk-Based Net Worth for Natural Person Credit Unions
8. Consolidation of Corporate Credit Unions

Our CU is concerned that if the following issues are left unchanged, there will be severe, and possibly unrecoverable, repercussions to corporate credit unions, which in turn would have harmful effects on us and other natural person credit unions that rely upon them.

1. Time Period for Capital Ratio Attainment
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 deposits as perpetual capital within 12 months of the publication date of the final rule.

Our CU is not willing to contribute additional capital in such a short time frame, and in such an uncertain environment. Indeed, some credit unions may decide to pull their deposits from the corporate system as the result of such a precipitous move to achieving a 4% Leverage Ratio via PCC. This, in turn, would lead to liquidity concerns for corporates.

2. Retained Earnings Growth Model
We take issue with NCUA's assumptions regarding a corporate's ability to grow retained earnings under the proposed investment and ALM limitations (pages 99-101 in the proposed rule), and are of the opinion that it does not represent a reasonable or attainable mix.

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.

We are very troubled by analyses which indicate that there is no combination of assets—with a two-year average life and limited extension risk—that could generate sufficient margin to attract funding and pass a 300 basis point credit shock test. Further, the proposed limitations placed upon a corporate by these tests would 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 members.

In our view, the proposed spread widening of 300 bps appears to be an over-reaction by NCUA to a once-in-a-lifetime, completely unique event. Historical analysis indicates that, 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.

4. Weighted Average Asset Life
This provision limits the weighted average life (WAL) of a corporate credit union's aggregate assets to two years and includes loans to members. Such a requirement will have adverse implications for natural person credit unions seeking to fill liquidity needs with term loans from corporates. In order to keep the overall WAL of its portfolio within the two year limit, most of the loans made by a corporate will be limited to shorter-term maturities. For longer-term loans, a corporate will have to substantially increase the rate offered in order to compensate for the impact the longer term will have on its two year WAL test.

As a result, long-term financing to our CU and other natural person credit unions will be drastically reduced, and will come with a much higher borrowing cost. Currently, less than 25% of California and Nevada credit unions are members of the FHLB. The remaining credit unions rely on a corporate to obtain term lending. Therefore, the two year proposed limitation will force us and hundreds of other credit unions—in California and Nevada alone—to seek less beneficial, or more expensive, funding from other sources. In addition, many natural person credit unions use longer term borrowings to mitigate interest rate risk. A limitation on borrowings from corporates to two years would take away an important tool for these credit unions.

5. Legacy Assets in Corporate Credit Unions
While we are aware that NCUA has made public statements indicating that it will announce plans in April 2010 for addressing legacy assets, we are puzzled as to why this critical topic is not mentioned at all in the proposed rule. Dealing with investment securities remaining on corporates' books is vital to realizing any lasting, consequential changes to the corporate system. These assets—by some estimates believed to represent as much as $30 billion in eventual losses, or one-third of all natural person credit union net worth—continue to create instability in the network, and serve as a major disincentive to credit unions providing any future capital contributions. No investor will invest unless the toxic assets are segregated so that new capital is not at risk. We believe that failure to address this issue invites the weakening of even currently stable corporates, and would serve to negate the positive changes that NCUA and credit unions would like to see in the corporate system.

6. Qualifications of Directors
The proposal requires, as qualification for directorship, that all candidates must currently hold the equivalent of a CEO, CFO, or chief operating officer (COO) position at the member institution (typically, though not always, a natural person credit union). We do not agree that a particular job title necessarily makes for a better board member, and instead suggest that NCUA consider that directors of corporates that may not have full experience or training needed in a particular area be required to obtain training on an annual or other periodic basis as a condition of service on a corporate board. There are a variety of credit union training programs, schools, online resources for board members which the NCUA could evaluate (possible every one to two years) and approve for use to meet such a standard. The goal should be that directors serving on a corporate credit union board have sufficient "skin in the game" and analytical ability to effectively look after member credit unions' interests.

We are of the opinion that a maximum of nine years (as compared to six) provides a more reasonable and useful time for training and developing directors as well as for benefiting from the investment in their development. Extending the term limit to nine years further allows for much needed continuity for a corporate without compromising the benefits that may be realized from bringing on new directors.

7. Risk-Based Net Worth for Natural Person Credit Unions
We strongly support adoption of risk-based capital among corporate credit unions. Corporate credit unions and natural person credit unions, alike, have been operating in an outdated capital framework that is out-of-step with the broader financial sector and worldwide financial regulatory regimes. While it is beyond the scope of Section 704, we take this opportunity to ask that risk-based capital be extended to natural person credit unions. As the corporate credit union meltdown clearly reminded the entire credit union system, not all assets are created equal and NCUA should modernize its measurement of capital adequacy to reflect the degree of risk associated with different assets. This change is fully within NCUA's regulatory authority, is low risk, and would provide many credit unions with relief while still maintaining strong and credible credit union net worth standards.

8. Consolidation of Corporate Credit Unions
We believe that corporate consolidation would be beneficial to the system, and that NCUA should be more open, responsive, and supportive of such consolidation by removing unreasonable impediments and/or resistance to corporate credit union mergers. We recognize that the current number of corporates is less than ideal with respect to efficiency and effectiveness (e.g., potentially redundant member capital requirements, duplication of expertise, staffing, and infrastructure). While we understand and approve of NCUA's avoidance in dictating the number of corporates in the system, we would like to see more open dialogue between NCUA, corporates, and credit unions regarding consolidation scenarios including the effect it would have on the viability of the entire credit union system. In identifying the "best" business model for corporates in the future, it is worthwhile to contemplate how much stronger and more valuable corporate credit unions would be to the nation, credit unions, and consumer-members if they adopted an FHLB-type model wherein corporates could raise money from selling bonds with the full faith and credit of the Treasury to support consumer and small business lending.

To summarize, we firmly believe that the Board should forego finalizing the above critical issues in their current proposed form, and should carefully assess all comments and analysis NCUA receives from commenters 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 earning growth assumptions. NCUA should also review whether historical trends justify the proposed tests and thresholds. Further, NCUA should transparently clarify how it intends to deal with legacy assets that remain on the books of corporate credit unions and what impact there will be on natural person credit unions upon the disposition of assets in question. Lastly, we believe that, in the spirit of transparency and fairness, NCUA should publicly provide its modeling tool and/or assumptions. 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 your for your consideration to this critical matter.

Sincerely,

Chris Coursen