PENNSYLVANIA CREDIT UNION ASSOCIATION
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March 9, 2010

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

Re: PCUA Comments on Part 704 Corporate Credit Unions

Dear Ms. Rupp:

The Pennsylvania Credit Union Association (PCUA) and its member credit unions support the continuation of the corporate credit union system, especially in their roles of cooperative providers of liquidity, settlement, and payment services for Pennsylvania credit unions of all sizes.

As a matter of background, the PCUA is a statewide trade association that represents a majority of the approximately 558 credit unions located within the Commonwealth of Pennsylvania. Due to the importance and impact of this proposal, PCUA consulted with its Board of Directors and its Government Affairs, Regulatory Review and State Advisory Committees (the Committees). The Association Board and Committees consist of credit union CEOs who lead the management teams of Pennsylvania federal and state-chartered credit unions. Members of the Board and Committees represent credit unions of all asset sizes. PCUA and our Committees also consulted with the management team of the Mid-Atlantic Corporate Federal Credit Union (Mid-Atlantic).

PCUA and its member credit unions agree with the National Credit Union Administration (NCUA) that the corporate credit union system should be restructured to prevent the problems of the past, to protect the National Credit Union Share Insurance Fund (NCUSIF), and to provide a regulatory environment for successfully operating in the future. Accordingly, we appreciate the opportunity to provide comments to the NCUA regarding its proposal to restructure the corporate credit union system.

We note that it is vitally important that the corporate credit union system be able to provide uninterrupted services at reasonable and competitive prices while they build the capital levels required and implement the other changes under the proposal. In addition, corporate credit unions must be able to pay a reasonable rate of return on member investments in order to remain competitive and relevant in the market place. The final regulation should reflect the following principals which are derived, in part, by findings of the CUNA Corporate Credit Union Task Force:

- In resolution of the corporate credit union issues, the interests of natural-person credit unions take priority.

- Corporate credit unions must adjust their current business model, recognizing credit union reluctance to investing significant capital in them. Along that line, corporate credit unions must have appropriate discretion to make investments and offer investment services in a prudent manner to meet the needs of natural person credit unions.

- Credit unions require access to settlement, payments, liquidity, investments and other correspondent services. We prefer that entities owned and controlled by credit unions deliver such services.

- Credit unions will not accept entities to meet their financial service needs that impose significant risks to them, either in the form of exposure of the capital invested by credit unions or through the share insurance fund. In short, the regulatory structure must prevent another systemic crisis.

- Those entities that emerge to meet the financial needs of credit unions will require some level of capital. That entities that succeed will be those that require less capital by assuming less risk and that offer key services that are effective and of low cost to credit unions.

Corporate Capital:

PCUA and its member credit unions generally support the revised capital levels and structure proposed for corporate credit unions.

Our Board and Committee members support adherence to the Basel I standards, including the risk-based and leverage ratio requirements. Our group conceptually agrees with the categories of perpetual and non-perpetual contributed capital. Further, we support the comments offered by Mid-Atlantic regarding the phase out of membership capital accounts (MCA) that are not converted into other forms of capital, as the current proposal would affect the viability of the corporate credit unions due to immediate downward shifts of their capital ratios.[1]

PCUA and its member credit unions support NCUA's goal to incorporate retained earnings into the corporate credit union capital calculation to create a buffer between future losses and member capital accounts and to protect the NCUSIF. However, we believe it is *absolutely imperative* that

[1] Mid-Atlantic Corporate comment letter (January 25, 2010), page 1.

NCUA extend the proposed phase-in period for achieving the designated percentages of core capital that must consist of retained earnings.

Under the proposal, a corporate must have a least 100 basis points (bp) of retained earnings within six years and 200 bp of retained earnings within ten years of the final rule to achieve the minimum 4% leverage ratio. This timeline, when combined with the proposed restrictions on investments spreads in particular, imposes undue pressure on the corporate credit unions.

Our member, natural person credit unions are experiencing their own operational pressures to reduce expenses and retain sufficient capital levels so they can continue to lend to their members. The undue pressure caused by the artificial deadlines in the proposal may leave corporate credit unions with no alternative other than imposing higher fees and capital requirements on their member credit unions at the same time NCUA is charging insurance premiums. This pressure to quickly capitalize corporate credit unions and build retained earnings, which could lead to an increase in prices for corporate services, may unnecessarily lead to the demise of the corporate credit union system.

PCUA's member credit unions are expressing concerns about the short timeframes that are being imposed upon them to make a decision whether to convert existing or contribute new capital into the corporate credit union system. Many feel that they do not have sufficient information regarding the level of risk they face going forward. Our smaller member credit unions especially expressed concerns over the safety of their capital in the corporate credit union system and the cost of services going forward.

We acknowledge that all relevant parties: the corporate credit unions, the natural person credit union members and NCUA, must "work hard" during the restructuring period to build a stable corporate credit union system. However, hard work alone cannot guarantee a corporate credit union's success in building the required levels of retained earnings. The economy and other outside forces will continue to be relevant. Our group believes that the proposed timeframe is unrealistic and is destined for failure should the current economic conditions persist longer than anticipated.

We wholly agree that building strong capital through retained earnings and stable capital investments is in the best interests of the entire credit union movement. However, if the corporate credit union system is to have a fair chance of success, the restructuring cannot be done post haste without consideration of the current condition and climate of our economy.

Even if spreads modeled in the proposal for building retained earnings were on target today, the spreads vary based upon the timeframe. The use of "current" values is an inappropriate benchmark for estimating the recapitalization of the entire corporate system. While these spreads may be historically wide, presumably the market will eventually migrate to historical non-credit crisis spreads. What will corporate credit unions do as spreads narrow and profitability shrinks to single digit percentages?

Allowing more time for the corporate credit unions to gradually build up their capital levels through effective monitoring of their business and capital restoration plans may help to mitigate the concerns of PCUA's member credit unions to make future capital investments in the corporate credit unions and thereby support their continued existence.

Minimum Capital Determinations and Prompt Corrective Action:

As noted above, we agree generally with the application of the Basel I standards imposed on other types of depository institutions. We further acknowledge the necessity of imposing prompt corrective action provisions on the corporate credit union system.

However, we reiterate the comments expressed by some of our colleagues that the regulator's "subjective judgment" caveat for determining appropriate minimum capital requirements is potentially too arbitrary. In particular, we are concerned about the overly broad statement that capital levels for an individual corporate cannot be determined solely through mathematical formulas but must be based in part on subjective judgment grounded in agency experience.

Likewise, our group raised concerns over the level of discretionary supervisory authority inherent in the prompt corrective action provisions related to an examiner's subjective opinions.

We do not contest the NCUA's authority and responsibility to oversee the safety and soundness of the credit union movement, including the corporate credit union system. However, as with any governmental power, there must be definitive standards pursuant to which a regulated entity can measure its condition and, therefore, remain free from excessive government oversight and control in its operations. We question whether the uncertainty created by including broad subjective discretion in the supervision of corporate credit unions contributes to the goal of creating stability and confidence in the corporate system.

Investments/Credit Risk Management/Asset Liability Management/Liquidity Management:

In the area of investments, our group was able to reach a consensus that corporate credit unions need to maintain enough flexibility and discretion to manage their investments so that they remain liquid to fulfill their role as liquidity providers. To that end, the majority of our group agreed that the proposed structure changes, ALM limitations, and testing requirements collectively are too restrictive.

Our group specifically agreed that the single obligor concentration limit should be increased to 100% of capital (as opposed to 25%) with regard to the cash deposits of corporate credit unions in other financial institutions. In order to stay within the proposed concentration limits, mid-size and larger corporate credit unions would be forced to migrate from the top tier of providers and, by doing so, potentially take on greater credit risk.

With regard to implementing the single obligor concentration limit on other investments, a majority of our group strongly believes that corporate credit unions must be able to manage their investments to provide yield and pay competitive rates to its members. However, a strong minority expressed concern that the credit risk in the corporate system should not be replaced with excessive interest rate risk so as to substitute one problem for another.

Ultimately, the majority of our group expressed that corporate credit unions need to produce yield for their members and that the corporate credit unions should be allowed the discretion to manage their portfolios with regard to their ultimate investment powers.

Our group agreed that standardizing the investment testing and monitoring criteria will benefit the corporate credit union system overall. However, most of our members expressed concern that the combination of the requirements for testing/limitations for investments/obligor concentration limits and spread testing is overly restrictive.

Most of our group believed the proposal to be overly specific and submitted that NCUA should set proposed targets for the entire business and let the corporate credit unions plan their business models with more flexibility to allow for maneuvering in changing market conditions.

It is important to note that there are certainly alternative liquidity, settlement and payment service providers, such as bankers' banks, that are natural competitors of corporate credit unions. Notwithstanding the available alternatives, our members expressed their desire to continue business with corporate credit unions due to the cooperative nature of their structure and the genuine belief in their philosophy. The majority of our group does not believe it is necessary to place the corporate system at a competitive disadvantage to other competitors by stripping the discretion from qualified corporate credit union professionals to make sound business judgments and investment decisions in credit risk, asset/liability, and liquidity management.

Corporate Credit Union Service Organizations (CUSOs):

PCUA and its members submit that there should be a phase-in period for obtaining permission for existing corporate credit union CUSOs so as to avoid the necessity to suspend activities of legitimate CUSOs while NCUA conducts its review.

The list of corporate credit union CUSO permissible activities in the proposed rule does not include some of the core services provided by corporate credit unions, such as payment services. As noted by Mid-Atlantic in its comment letter, Mid-Atlantic's payment services CUSO, My CU® Services, does not fall within the list and would need to be approved by the NCUA. Over 700 natural person credit unions and their individual members located in all 50 states would be severely impacted should Mid-Atlantic be required to suspend the services of their CUSO.

PCUA and its Committee members agree with NCUA's intent to more closely monitor the activities of corporate credit union CUSOs for purposes of analyzing the overall systematic risk created by the corporate CUSO activities.

<u>Board Governance and Representation</u>:

Our group submits that limiting eligible candidates to the CEO, CFO or COO positions can potentially disqualify some of the most qualified persons for corporate credit union director positions and limit the diversity of skill and knowledge on the board.

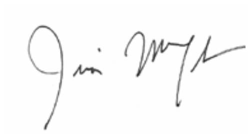
Instead, we support the imposition of characteristics and qualifications to help ensure that the most effective candidates may serve on the boards of corporate credit unions. CEOs, CFOs, and COOs often possess the types of qualifying characteristics that should be included. However, limiting board candidates to those holding the specifically listed titles is too restrictive. Knowledge and experience of the corporate credit union system and the services offered and provided should certainly be included as a qualification.

Finally, we strongly encourage NCUA to extend the term limit of a corporate credit union's director to 12 years instead of 6 years. A six year term limit is simply too short. It takes time to season a corporate credit union director through training, education, and experience. Due to the unique nature of corporate credit unions, it is important that directors can serve longer terms so that the corporate can benefit from their experience and knowledge. Requiring the board to turn over too quickly will lead to instability and ineffective governance.

Thank you again for this opportunity to provide comments on this very important proposal. Please feel free to contact me or any of the PCUA staff at 1-800-932-0661 if you have any questions or if you would like to discuss the contents of this letter.

Sincerely,

PENNSYLVANIA CREDIT UNION ASSOCIATION



James J. McCormack
President/CEO

JJM:LSK:llb

cc: Association Board
Governmental Affairs Committee
Regulatory Review Committee
State Credit Union Advisory Committee
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