



March 9, 2010

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

Dear Ms. Rupp:

RE: Proposed Changes to 12 CFR Part 704

On behalf of Digital Federal Credit Union, thank you for the opportunity to comment on NCUA's Proposed Corporate Credit Union Regulation. Overall, we applaud NCUA's efforts to restore a safe & sound business environment for the corporate credit unions that over extended themselves.

Throughout my career at DCU, we have utilized a considerable level of corporate credit union services. Having grown to approximately \$4 billion in assets, we are certainly in a position where alternative third party solutions could replace existing relationships with our corporate credit unions. Nonetheless, we believe that the products and services available through our corporate credit unions are valuable and competitive.

Providing feedback to this proposal has been done with a limited scope. The two key issues that remain unanswered at this point are:

1. How will legacy assets be handled?

Our understanding is that NCUA is considering a plan for how to deal with "legacy" assets. There is a general agreement that most, if not all credit unions would be reluctant to participate in the recapitalization of a corporate credit union as long as these assets remain in the surviving entity. While we can appreciate that perspective, we are concerned how this could affect our overall cost through the Temporary Corporate Credit Union Stabilization Fund. Once this plan is finalized, the impact of this proposed regulation in conjunction with that plan will be critical. An opportunity to provide additional feedback once the plan is available should be strongly considered.

2. What are the results of third party modeling of ALM and earnings?

There are a number of questions related to the modeling performed to arrive at the ALM and earnings requirements incorporated into this proposal. Our understanding is that

NCUA has engaged a third party to independently assess the reasonableness of these areas. The ability to review that analysis in conjunction with the proposal is important.

Overall we will provide feedback on a number of items addressed in the proposed regulation. Failure to comment on a specific item within the proposal should not be interpreted as agreement. There are a number of areas where others are more qualified to assess and comment on specific elements of the proposal. For example, we do not consider ourselves experts in the area of risk based capital models of all of the regulatory agencies.

§704.3 Corporate Credit Union Capital

Through this section of the proposal, “NCUA intends to change the corporate capital requirements to make them stronger and more consistent with the requirements of the banking regulators.” In this regard, the proposal includes a significant number of changes. This includes:

1. Assessment of 3 capital ratio (Leverage, Tier 1 Risk Based, & Total Risk Based),
2. Components of each level of capital, and
3. Modified characteristics of capital.

Determination of Assets and Risk Based Assets – Although inconsistent with other regulatory models, Daily Average Net Assets (DANA) and Daily Average Net Risk-weighted Assets (DANRA) are utilized for calculating capital ratios. While it appears that this was utilized to consider seasonal variations in total assets, it may not be representative of a corporate credit union’s situation at any given time.

Consideration should be given to providing options in the determination method of calculating the denominator. All corporate credit unions are not the same. This would provide each the ability to utilize the method deemed most appropriate. For example in section 702 Prompt Corrective Action, NPCU are provided alternative calculation methodologies to provide flexibility.

§ 702.101 - (1) Total assets means a credit union’s total assets as measured by either—
(i) Average quarterly balance. The average of quarter-end balances of the current and three preceding calendar quarters; or
(ii) Average monthly balance. The average of month-end balances over the three calendar months of the calendar quarter; or
(iii) Average daily balance. The average daily balance over the calendar quarter; or
(iv) Quarter-end balance. The quarter-end balance of the calendar quarter as reported on the credit union’s Call Report

Additionally, paragraph 704.3(e) addresses situations where the agency believes it is necessary to override management methodology. NCUA can ...“Require a corporate to compute its capital ratios on the basis of period-end, rather than average, assets when it is appropriate to carry out the purposes of part 704”.

Requirements for Tier 2 capital accounts – Membership Capital Accounts (i.e., MCAs) currently have a minimum three year requirement. The proposal would lengthen the minimum term to five years. In an economic environment where acquiring additional capital will be difficult, NCUA has created an approach that will eliminate any value to these accounts as capital unless converted to 5 year notice. At the same time, the cost of carrying this debt may remain. A question remains as to the proposed changes. Once the minimum for MCA is changed from 3 to 5 years, would corporate credit unions still be required to obtain NCUA approval prior to calling these (no longer capital) instruments?

There is no quick solution to issues currently being experienced by corporate credit unions. Even without OTTI write-downs, some corporate credit unions experienced the loss of most or all retained earnings. NCUA should consider some level of value for 3 year MCA accounts provided notice has not been given.

One possibility would be to allow 60% value if notice has not been provided (based on 3 years representing 60% of 5 years). Once notice is given, the value as tier 2 capital would be amortized monthly (from 60% of value), similar to the current proposal.

While the value of this approach will vary based on an individual corporate's situation, it would add a level of stability to corporate credit unions where the value of MCA accounts has not been impaired.

Transferability of Corporate Capital Instruments – The proposal requires a member be permitted to transfer corporate capital instruments they hold to third parties (members and non-members). This proposal creates a number of difficulties including the uncertainty related to existing corporate capital instruments.

Currently corporate credit unions have a number of existing capital instruments outstanding that would require modifications to enable compliance with these proposed changes. Being legally binding agreements, it is unclear what would be involved to modify these agreements to conform to this proposal.

A desire to diversify capital instrument holders to include non-members outside the credit union industry is understandable. Nonetheless, it is unclear what the registration requirements are that would be involved in structuring this type of instrument. What if a member credit union wanted to sell these to its employees? There would appear to be issues with ensuring that an educated investor is on the other side of the transaction in this as well as many other hypothetical cases.

While the current regulation provides this as an option for inclusion in a capital instrument, it is unclear if any have utilized this option to date. While maintaining this as an option, specified and disclosed at the time of issuance by individual corporate credit unions, making it a requirement will not create diversification. Furthermore, at a minimum the proposal should specifically state that it grandfather existing instruments. While not specifically stated, it seems to be the intention of NCUA based on a review of "IV.B. Paperwork Reduction Act."

Acceptable elements of corporate capital - The Proposed Regulation would require a retained earnings ratio of 45 basis points of assets no later than three years following the effective date. There have been numerous suggestions that this target is not realistic. NCUA has indicated the engagement of a third party to independently evaluate the feasibility of this proposal. As discussed earlier, public disclosure of this entire analysis would provide valuable assistance in understanding the methodology and assumptions utilized in this process. Once this is done, an opportunity for further feedback would be appropriate..

§704.8 Asset and Liability Management

The Proposed Regulation would codify two additional tests related to NEV modeling for asset liability management purposes. There has been considerable discussion regarding the viability of these proposed parameters presented in the “examples” portfolio. This appears to include the use of derivatives, a tool some corporate credit unions are not inclined or authorized to use.

While achieving these additional measures is possible, it seems to conflict with attaining the earnings proposals. As indicated above, the third party analysis commissioned by NCUA should be made available for review in conjunction with this proposed regulation.

§704.11 Corporate Credit Union Service Organizations (Corporate CUSOs)

The proposed regulation replaces the current list of prohibited activities with a section on permissible activities, which is limited to brokerage and investment advisory services. Although there is an “other category of services as pre-approved by NCUA”, at this point there is no indication any exist. Consequently, a corporate with existing CUSO activities outside this list would be prohibited. This change is being proposed despite a corporate credit union having a legal ownership interest in one or more CUSOs.

In regard to existing CUSO relationships, NCUA should “grandfather” these CUSOs. This would seem justified based on the current examination process. NCUA has an active presence in all corporate credit unions, and through the examination process has built a good understanding of corporate credit union participation with individual CUSOs. Additionally, creating doubt in the marketplace about a CUSOs long-term viability (by virtue of its absence from the approved list) could cause unwanted risk.

As a means of supplementing the “grandfathering” process, corporate credit unions could be required to submit a one-time summary for each CUSO falling into this category. This report could include pre-established information desired to allow NCUA to ensure it maintains an understanding of each grandfathered CUSO.

Regarding the list of approved activities, NCUA should utilize knowledge of existing activities to expand the list of approved activities. While it will never be all inclusive, there are activities being performed through CUSOs that could be included, some examples include:

- Item Processing
- Statement Processing
- ACH Processing
- Safekeeping
- Asset Liability Management Services
- Risk Management

§704.14 Representation

The Proposed Regulation would limit Board members from serving more than 6 years. This proposal presents short-term as well as long-term implications.

- Short-term, based on the tenure of a significant number of board members, these individuals would be ineligible for reelection when their terms expire. This would create a large amount of turnover in a short period of time. This does not seem beneficial to an individual corporate credit union's governance in this environment.
- Long-term this approach will create a revolving door of directors. Similar to the nurturing of an examiner, board members take time to come up to speed on all of the issues confronting them in a new role. Depending on the level of complexity, this can take a year or two before an individual gains a high level of comfort. This significantly limits the period of time a director can be truly adding value.

Overall, term limitations would create an additional destabilizing force for corporate credit unions to deal with in these trying times. This does not seem to be the most appropriate time to implement this type of change. Although deleting this provision from the proposed regulation would seem to be the better approach, a longer term such as 10 years would allow for a more reasonable level of turnover if term limitations are used at all.

In closing, we thank you once again for this opportunity to comment on the Proposed Corporate Credit Union Regulation. We look forward to additional communication related to the handling of legacy assets, as well as the third party modeling.

Sincerely,

A handwritten signature in black ink that reads "J Regan". The signature is fluid and cursive, with a large initial "J" and a long, sweeping underline.

James F Regan
President/CEO