Kansas Credit Union Association

March 9, 2010

Ms. Mary Rupp
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314-34218

Dear Ms. Rupp:

I am pleased to comment on the proposed amendments to the National Credit Union Administration's rule governing corporate credit unions contained in part 702, 703, 704, 709 and 747. I trust my service as former regulator of Kansas state-chartered credit unions will provide a distinct perspective about the proposed changes to the corporate rule.

The Kansas Credit Union Association (KCUA) represents the collective interests of the state's 105 credit unions, all of which have a significant interest in the success and viability of the Kansas Corporate Credit Union (KCCU). The KCUA works in partnership with KCCU to provide settlement services for credit unions and has a fundamental interest in the success of KCCU and credit unions alike.

The KCCU serves as the primary provider of investment, liquidity, settlement and advisory services to our credit unions so it is critical that the proposed amendments to the corporate credit union "CCU" rule be fair and flexible enough to allow KCCU to continue operations in Kansas.

My comments identify five areas including **Capital, Investments, Asset & Liability Management, Liquidity Management and Corporate Governance** for NCUA to consider prior to finalizing the proposed corporate rule. Generally, you will find my comments seek to encourage NCUA to be very cautious about making the regulations so restrictive that a CCU will be unable to function. I believe NCUA must establish regulations that give the NCUA and the CCUs options rather than tightening the regulations so much as to strangle the organizations our credit unions depend on every day to serve credit union members.

Comments are as follows:

<u>Capital</u>

NCUA should consider excluding off-balance sheet items from the risked-based assets calculation. The underlying purpose of using off-balance sheet items is to limit or eliminate the risk to a CCU. An alternative may be to allow a CCU to establish a distinct capital pool for off-

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balance sheet items to prevent any confusion about the items having the same risk as on-balance sheet assets of the CCU.

Under the proposed components of "core capital" and "supplementary capital," a CUU should be allowed to recognize the value of 100% of net unrealized gains on available-for-sale equity securities and allowed to include a higher percentage of GAAP ALLL risk-weighted DANA when a CCU has placed the securities for actual sale.

NCUA should consider an exception to the proposed requirement for a deduction from capital for capital accounts that a CCU holds in another CCU, especially when there is a deminimis member capital contribution between CCUs. An analysis of the portfolio risk of another CCU should be allowed and only when high risk is identified should the deduction be required based on the established risk of the CCU.

The proposed rule's phase-in for CCU retained earnings minimum levels**,** found in the section 704.2 definition of "adjusted core capital" (which effectively requires a CCU to have at least 100 bp of retained earnings after 6 years, and at least 200 bp after 10 years)**,** is unreasonable considering the current levels of capital in CCUs. If no exceptions are allowed, it is likely to encourage aggressive strategies to accumulate retained earnings or cause a CCU to solicit high cost capital. CCUs must not be unnecessarily forced into a survival mode while rebuilding capital.

The proposed retained earnings requirements (at least 100 bp after 6 years and at least 200 bp after 10 years, to be adequately capitalized) may be appropriate**,** but the proposed rule should give more thought to the required capital levels in light of the risk within a particular CCU. The rule should allow lower minimum capital requirement when a CCU can function as a low-risk CCU.

A CCU that has not achieved 45 bp of retained earnings after three (3) years should only be required to submit a Retained Earnings Accumulation Plan to NCUA when the CCU is unable to produce positive retained earning growth each year after three (3) years.

NCUA should give serious consideration before requiring any mandatory action under the proposed rule. Any provision which calls for mandatory supervisory action takes options away from the agency in a time when the agency needs to have more options available to them.

The proposed changes to investment and ALM rules**,** which prohibit the purchase of net interest margin securities and of collateralized debt obligations**,** will reduce the ability of a CCU to produce income. This prohibition presumes that a CUU is incapable of choosing, monitoring and managing these assets and has the appearance of being based solely on current market weaknesses.

While it is valuable for NCUA to look back at what <u>could have been</u> if USC**,** FCU and WesCorp had not been holding the now viewed bad investments, we must consider that this backward view is incomplete because it is unknown what types of investments would have been held.

Investments

Generally, the proposed restrictions on investment authorities and the added asset-liability management requirements will likely result in significantly lower returns for CCUs which**,** in turn**,** will impede the CCUs' ability to meet the new capital standards under the new rule.

More specifically, NCUA, as a safety and soundness regulator, has little choice but to consider a ban of investments in the types of instruments that currently hold the greatest risk to the CCU system. What seems unreasonable is to ban these investments without giving a CCU the opportunity to be exempt upon showing expertise within the specific investment area.

In addition to permitting CCUs to invest in national bank and mutual thrift collective investment funds**,** NCUA should consider allowing investment in SEC-registered investment companies. The exclusion from investment in these investment funds presumes that they are inherently more risky than national bank and mutual thrift collective investment funds.

NCUA's proposal to require that at least 90% of a CCU's investment portfolio be rated by at least two nationally-recognized statistical ratings organizations is unreasonable. CCUs**,** and many other entities**,** used nationally-recognized ratings**'** organizations in the past and there is little evidence that CCUs using these ratings organizations had less risk exposure.

A CCU would be better served if NCUA established an approved list of nationally-recognized ratings agencies, thus allowing a CCU to select one or more agency ratings for their investment analyses.

NCUA's efforts to revise expanded investment authorities appear to be an effort to help CCUs avoid risk going forward based on past investment problems areas. NCUA should allow a CCU's investment authorities to vary based on the expertise within a CCU.

Restriction of CUSO activities to only the most basic services is contrary to the purpose of using a CUSO to provide benefits to the CCU membership. NCUA should establish a comprehensive list and only require written approval for an activity not on the list. This prohibition seems especially harsh when viewed in conjunction with NCUA's proposal to reduce to CCU CUSO investment and limits on loans. The impact appears to have a doubly harsh affect in a time when CCUs may be looking to their CUSOs to help provide more services to their members.

NCUA should use caution before they adopt a rule that subjects the CUSO as a corporation to higher scrutiny than another like corporation. NCUA's review should be based on safety and soundness regulation which would require NCUA to determine that the CCU CUSO loans and investments are within the authority provided under the CCU regulation. Any effort by NCUA to limit the operations of the CUSO beyond true regulatory compliance would seem to be inappropriate.

Asset & Liability Management

NCUA should strongly consider a revision to the new spread widening test as the new rule appears to be overly harsh. This new test seems to eliminate the purchase of floating-rate investments as an option for a CCU since the net effect is to alter the value in such a way as to treat it as a fixed rate investment. An alternative might be to allow a CCU to use a variable stress widening test based on the core value of the investment, essentially taking into account the underlying risk of the investment. One could easily argue that a government agency floating-rate investment has less risk than a non-agency, thus should be measured based on the lower risk.

NCUA may be well served to allow a CCU to have the ability to establish a more flexible weighted average life of the CCU's assets than the two year limit in the proposal. Like many of the other limitations, the new rule treats every CCU identically, leaving no flexibility for a CCU to be recognized for expertise. Such a limitation might prove to tie the hands of the agency.

Liquidity Management

NCUA should have the ability to make an exception to the proposed 30 day CCU borrowing limit if the CCU can show that an exception may benefit the CCU or show the lack of an exception may harm the CCU. In addition, both a well capitalized and adequately capitalized CCU should be allowed to borrow for non-liquidity purposes if they can show it may benefit the CCU and that the restriction exposes the CCU to no extraordinary risk.

Corporate Governance

NCUA currently has the ability to rate management on established policies, so a change to standard bylaws may be excessive regarding a mandate for a policy for newly-elected and incumbent directors and volunteers.

The proposal containing the requirement for potential CCU directors to hold positions of CEO, CFO or COO at a member institution would exclude individuals who have expertise but not the right title at a member institution. A more appropriate requirement may be to establish professional and/or education standards for the director positions as is the intent of the proposed bylaw amendment.

The proposal, to require a majority of the directors within 36-months of the final rule to be representatives of member NPCU, assumes that a CCU will have no challenge in soliciting directors to replace outgoing directors. This proposal may be too restrictive for CCUs in less populated geographic areas with a less dense pool of candidates. The proposal would be more reasonable if a CCU would be allowed to ask for an extension period if compliance become problematic.

NCUA appears to be stepping far beyond their role as a safety and soundness regulator by proposing an annual disclosure or disclosure upon request of the compensation of executive officers and directors. NCUA should require a CCU to disclose information equal to but no more than is required by the IRS 990 filing requirements.

If NCUA adopted the proposed compensation disclosure requirements for material increases in compensation, it would be appropriate to base the disclosure of the compensation solely on material increases in compensation regardless of which entity is assuming control.

Finally, my overall sense of NCUA's intent is to structure the CCU system in such a way as to push more risk to the balance sheet of a NPCU which, in turn, creates more risk in a NPCU and creates a need for higher levels of ALM expertise in a NPCU. NPCUs rely on a CCU to assist with ALM strategies, but I fear that on the whole, this proposed CCU rule may lead to the demise of many CCUs. Most NPCUs may have little ability or interest in accepting this new systemic risk and without a CCU, the average NPCU will be forced to deal directly with investment advisors who exist for a far different purpose than a NPCU and CCU. Is NCUA prepared to deal with this new systemic risk which is a direct consequence of making the CCU rule so restrictive?

Please accept my comments in support of your effort to improve the CCU System and feel free to contact me any time.

Best Regards,

Jerel Wright
AVP – Consulting and Compliance
Kansas Credit Union Association