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To: _Regulatory Comments
Cc: 'chris@ccul.org'
Subject: NCUA Proposed Amendments to Corporate Rule
Attachments: NCUA Comment letter on corporates.doc

On November 18, 2010, NCUA issued a proposal to amend its corporate credit union rule, contained in Part 704 of NCUA's Rules and Regulations. I would like to provide NCUA with comments regarding the proposed rule making.

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A Limit on Natural Person Credit Union Membership in One Corporate Credit Union (701.5)

I oppose limiting the number of corporate credit unions that a natural person credit union can join. While I agree with NCUA that it is desirable to limit excessive risk taking, this is the wrong solution to that problem. NCUA has adequate regulatory powers to prevent excessive risk taking. In fact NCUA had adequate regulatory authority to prevent excessive risk taking before the collapse of the corporate system. What was lacking was an examination process that identified excessive risk taking. Until NCUA corrects the examination issues, the credit union system remains at risk of future corporate credit union failures.

There is benefit from allowing credit unions to belong to multiple corporates. Some corporates offer unique services and some may provide better service than other corporates. Credit Unions should be allowed to use the best services from whatever corporates they want to do business with. Competition is generally perceived, in our capitalist economy, to spur innovation, lower prices and improve service. Competition should be encouraged in the corporate system.

Corporate credit unions will be competing with a host of non-corporate competitors. It is a common misconception within credit unions, and apparently at NCUA that the greatest competition comes from other credit unions, and in this particular case from other corporates. It is just as reasonable to assume that the corporates will respond to competition from non-corporate competitors by taking excessive risks as it is to assume that they will respond to competition from other corporates by taking excessive risk. Therefore it would be illogical to believe that excessive risk taking caused by market competitors can be eliminated by limiting competition among corporates.

The issue isn't that excessive risk taking results from competition but rather that in this crisis, the NCUA was unable to identify and then take prompt corrective action when excessive risks were taken by corporate credit unions. Excessive risk taking will be caused by a variety of business conditions. NCUA would be far better off focusing on how to measure and monitor risk than to try to eliminate all of the business factors that lead to excessive risk. In this case the unintended consequence of limiting how many corporates a credit union can join has an obvious negative impact on credit unions. NCUA must demonstrate that as the corporate system regulator, the agency can adequately assess the risks taken by corporate credit unions and then determine whether the corporate's controls are adequate to mitigate those risks so that the corporate can operate in a safe and sound manner. It appears that instead of fixing the oversight and examination shortcomings the solution is instead to draw such tight limits around the corporate that there is no risk and therefore no real business model. NCUA's current corporate regulation has significantly limited the risks that a corporate can take and has

increased the capital requirements at the same time. Unfortunately the very tight regulations will mean that other vendors will be more attractive than the corporate system under the new rules. In that case we will certainly never have another corporate failure--because natural person credit unions will move all of their business to other vendors and the corporate system will go away.

The fundamental mistake in all of the proposed regulatory changes is that all of the risks that were not well managed in the corporate system have been moved them to other vendors and ultimately to the natural person credit unions to assume and manage those risks with less resources than the corporate had. Our credit union now has a large portfolio of government agencies securities. Our credit union has assumed all of the investment functions once done at the Wescopr. We are making investments at higher per unit transaction costs; our investment team has less expertise than Wescorp had; and we have to manage brokers (the same people described in "The Big Short") who themselves lack regulation and by all accounts have no business ethics.

The credit union system would be far better off with the old corporate system (provided we fix the real problems) than what we are going to have. The real problems that caused the corporate credit union collapse include; rating agencies that did not do their job; brokers who lied and cheated; investment banks that packaged junk and sold it with rating agency triple AAA ratings; and regulators who did not do their job of stopping criminal abuses at all levels of the investment chain from the mortgage brokers who made the loans to the investment banks that packaged them.. The corporate boards did not see the real problems--no one did. But we see them now and unfortunately they are not being addressed. Instead we are going to punish the victims who sat on corporate boards and did the best they could in a system that was gaming against them. Not only is that unfair, it is unwise and it assures that the there will be another crisis.

Equitable Distribution of Corporate Credit Union Stabilization Expenses (704.21)

I don't see any reason to force non-FICU credit unions to pay "their share" of the corporate credit union losses. I don't advocate private insurance, but I think there is value in having an alternative insurance and an alternative charter so that credit unions can choose whether to have a Federal or a State charter. The two competing charters assure innovation and progress in credit union regulation. If NCUA forces non-FICU credit unions to pay their share it would negate the advantage of having two charter options. I oppose anything that would negate the advantages of having two separate charter options.

Other proposed rule changes;

1. **Require Corporate Credit Unions to maintain a record of all director votes, including how each director voted.** We record any no votes or any recusals in our minutes. I believe it is a regular practice to record no votes and the names of directors who recues themselves from a vote. I support this change.

2. **Qualifications of Corporate Directors.** I agree with the proposed changes in the qualifications of corporate directors. The NCUA should also consider aligning voting rights with the amount of capital that an individual credit union has at risk. Our credit union had over \$13 million in capital invested at Wescorp. Our one vote for the Board of Director candidates was equal to that of every other credit union despite our much higher “at risk” ownership of the corporate. That is bad governance and has a big bearing on the quality of directors who are elected. Our voting power, if we had been given proportionate voting power, would have elected a much different Board of Directors. There is a no guarantee that requiring directors to be CEO, COO or CFO will make them qualified. I agree it will help raise the bar. But I am certain that those credit unions with the most capital at risk will carefully assess the quality of the candidates that are up for election and will in most cases recruit from their own organization qualified candidates. NCUA should allow voting for the Board and in all member voting situations to be proportionate to the dollar amount of capital invested. Ownership and voting have to be proportionate to assure that the owner's interest at risk and the owner's voting power are equal.
3. **Require compensation received by highly compensated corporate credit union executives be disclosed.** I favor transparency and endorse the disclosure of compensation. However I suspect that NCUA's reasons for disclosing compensation are misguided. The best judge of how much to compensate the executives is the Board who oversees those executives. NCUA should also require the Board to disclose their compensation policy and their procedure for assuring that compensation is equitable. A good CEO will be paid more than a bad CEO. If the corporate only discloses the amount of compensation, the reader has inadequate information to judge whether the amount of compensation is reasonable.
4. **Apply Sarbanes Oxley rules to Corporates.** Corporates will require membership capital in order to meet NCUA's new capital guidelines. It is reasonable to require corporates to fully implement Sarbanes Oxley because in many ways a corporate will be similar to a public company. The Supervisory Committee in particular should have similar qualifications as the Board of Directors and meet the Sarbanes Oxley requirement that at least one member of the Committee be a “financial expert”.
5. **Require an enterprise-wide risk management committee with a risk management expert.** I agree with this requirement. However I suggest that NCUA's Inspector General investigate why the independent risk management function at Wescorp did not work. Wescorp had an independent Vice President of Risk Management. The huge losses at Wescorp call into question whether or not an independent risk management function will work. The testimony by various witnesses before the Financial Crisis Inquiry Commission indicated that Citicorp and other major banks had independent risk management functions and they doo failed to prevent major losses and did not alert management of high levels of enterprise risk. The concept has merit but if we don't understand why it failed in this crisis, it is doubtful whether the cost of having an independent risk management function will be worthwhile.

5. **The three legged stool of a safe and sound credit union system (corporate or natural person credit union—it applies equally).** I remember how NCUA responded to the CapCorp collapse. The response is very similar to the current response, regulations were rewritten and the rules were tightened. The changes did not prevent the current crisis. I'm not sure these changes will prevent the next failure. There are three legs to a safe and sound credit union system; we must have Boards and management (the M in CAMEL) that operate the institution in a safe and sound manner; we need regulators who verify that the Board and management are operating the credit union in a safe and sound manner; and we need members who elect qualified Board and Supervisory Committees and hold them accountable for running a good credit union. We failed in the CapCorp collapse to address the third leg—the members and I believe we are failing to address the members in this regulation. Yes, we are going to require members to contribute capital and that will make them pay more attention. That much is for sure. But members are largely the last to know when an institution is in trouble. Members never see the examination findings, they don't see the auditors letter to management, and the financial statements are not always a leading indicator of problems. The members in most corporates had no clue that there was a massive problem in the corporate system. I propose that examination reports be made public. Why shouldn't members know that examiners are concerned about certain problems? Members elect the Board and Supervisory Committee. They can hold them accountable. Members have a vested interest. We no longer have to fear runs on financial institutions. It is clear that government policy is to step in and prevent runs as happen in the recent corporate collapses. We have more to fear from Boards who do not take action or regulators who do not practice prompt and corrective action. We claim credit unions are member owned. Doesn't the owner have a right to see the examination findings and a responsibility to hold the Board and Supervisory Committee responsible? At the very least a corporate credit union member is more sophisticated than a natural person credit union member. If we require member contributed capital the credit union member is at risk. I believe it is imperative that we share with the member the examination findings. It will make both the regulator and the regulated more accountable. Our credit union system is built on the involvement of the member. Our confidential examination process prevents the member from being a check and balance; it takes away his ownership duty to assure good governance; and it increases the chance that we will continue having these corporate collapses.