



National Association
of Federal Credit Unions
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NAFCU | Your Direct Connection to Education, Advocacy & Advancement

January 28, 2011

Mary Rupp
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314

RE: Proposed Rule to Amend Part 704-Corporate Credit Unions

Dear Ms. Rupp:

On behalf of the National Association of Federal Credit Unions (NAFCU), the only trade association that exclusively represents federal credit unions (FCUs), I am writing to you regarding the National Credit Union Administration's (NCUA) most recent proposed rule regarding corporate credit unions. *See* 75 FR 7300 (Nov. 29, 2010). The proposed rule follows NCUA's recent comprehensive changes to 12 CFR part 704 (September 2010 Corporate Rule).

NAFCU appreciates the opportunity to provide comments on the specific issues raised in the proposed rule. While we offer comments on the various components of the proposal, we would like to first address the timing of the proposed rule.

Specifically, NAFCU understands that corporate credit unions are currently formulating and finalizing their plans to comply with the recently amended capital rules that are contained in the September 2010 Corporate Rule. After finalizing their plans, the corporates must implement them and ensure that they meet the capital rules by the various deadlines in the coming year and on. NAFCU strongly urges NCUA to consider the impact that the addition of the proposed changes would have on the ability of corporates to fully implement their capital plans and meet the new regulatory capital requirements. NCUA should also consider the impact that the proposed changes would have on ongoing corporate merger plans.

Membership Limited to One Corporate Credit Union

A main feature of the proposed rule would limit to one the number of corporate credit unions in which a natural person credit union (NPCU) can be a member at any one time. Among NCUA's key stated reasons for imposing such a limit is to prevent "rate shopping" by natural person credit unions. Under the proposal, a NPCU may belong to more than one corporate only when it intends to transfer its share and deposit accounts to another corporate, and membership to two corporates under such circumstances is limited to six months. Also, the proposed rule would only have prospective affect; so, NPCUs

that currently have memberships with multiple corporates may retain each of those memberships.

NAFCU reiterates our strongly held position that the future of the corporate credit union system should be determined by 'member-owner' natural person credit unions. The ultimate determination of the services to be provided by corporate credit unions, as well as the size, scope and extent of the corporate system, must rest with their 'member-owner' natural person credit unions that are rapidly moving forward to set the course and direction of their corporates for the future. We also believe NPCUs should consider diversification, to include exploring alternative service providers as a 'fall back' in the unfortunate event there is a disruption in an institution's products and services.

Unfortunately, the proposed membership limitation is contrary to the principle that member-owner natural person credit unions determine the future of their corporates and the corporate system as a whole. As a result, NAFCU strongly opposes this aspect of the proposed rule. As explained below, we believe the proposed membership limitations would have a significant and potentially dire effect on the credit union industry.

We believe the proposed membership limitation will lead to more, not less, competition initially, and over time could lead to the undesirable outcome of creating large corporates that are "too big to fail." In the short term, corporates would compete greatly to attract member credit unions. During this period, credit unions would understandably seek the best rates available for products and services. It may, then, be inevitable that corporate mergers and consolidations are accelerated and very few will be left standing. The few that are left standing would likely be "too big to fail." If consolidations and mergers among corporates result from business decisions made by credit unions over time, such an outcome will be informed by credit unions' business needs and decisions. On the other hand, corporate mergers effected even in part by the proposed membership limitation are more likely to be less informed and as a result, would limit the benefits that market-driven mergers would otherwise bestow on corporate-member credit unions.

Related to the "too big to fail" concern is the potential that the proposed rule could increase concentration risk, potentially rapidly, and as a result threaten the National Credit Union Share Insurance Fund (NCUSIF). Small and large credit unions alike currently use multiple corporates for a range of products and services and have millions of dollars in liquidity spread across multiple corporates. However, increase in concentration risk will come about if they eventually re-allocate their assets to one corporate.

Additionally, NAFCU is concerned that the proposed membership limitation could eventually result in dilution of quality in corporate products and services. Credit unions have found using different corporates for different services allows them to obtain the best services available. We are concerned that superficial non-market driven corporate consolidations could inadvertently promote lack of market discipline and,

consequently, a decline in quality of services. Ultimately, this would handicap natural person credit unions' ability to offer their members low-cost products and services.

Further, the proposed rule could effectively force the removal of a potentially significant amount of assets out of the credit union industry. The September 2010 Corporate Rule restricts the percentage of assets that a corporate may hold from any one credit union to 15% of the corporate's assets. Thus, if the proposed limitation to membership is adopted, a natural person credit union that would like to invest additional capital would not be able to do so if the result would lead the corporate to exceed the 15% threshold. As a result, the natural person credit union would be forced to take its assets outside the credit union system. Effectively, a decision that should be made by the NPCU regarding its investments would be made by regulation.

NAFCU does not believe that this is a desirable outcome. Rather, policies and regulations regarding credit union investment powers should be geared toward allowing them to make informed decisions with as many available options as possible. We believe the options should include the ability to decide to invest in multiple corporates and keeping their assets within the credit union industry.

Equitable Distribution of Corporate Credit Union Stabilization Expenses

Currently, only federally-insured credit unions (FICUs) are assessed for expenses relative to the Temporary Corporate Credit Union Stabilization Fund (Stabilization Fund). NCUA's proposal contains a mechanism that seeks to ensure that all non-FICUs contribute their share towards corporate stabilization costs. The agency's mechanism would involve non-FICUs making voluntary payments upon request, with refusal to do so potentially subjecting them to a vote to be expelled by their corporate's membership. Non-FICUs, for purposes of this proposal, include both privately-insured credit unions as well as other entities that are corporate members, such as credit union service organizations (CUSOs).

NAFCU understands the agency's intent in this aspect of the proposal, which is to spread the cost of corporate stabilization to all entities that have benefited from using the corporates. In this regard, there can be no question that those that did not use the corporate system have had to unfairly shoulder the burden of the mistakes that were made. NAFCU, however, strongly believes that member-owners of corporates and their boards should make decisions regarding the course of the institution.

We also have concerns about how this mechanism would work in practice as such entities would simply choose to abandon the corporate credit union system and thus have no incentive to recapitalize the corporates. Further, we want to avoid a situation with respect to the extension of the proposed mechanism to FICU-owned CUSOs or trade associations where a FICU could have to pay more than their fair share of the costs of corporate stabilization. That is, FICUs would be assessed first directly by NCUA. Then, following their CUSO's voluntary payment upon NCUA's request, they could have to

shoulder a second cost associated with corporate stabilization expenses through increased fees and costs they would be charged to recover the payments made by the CUSO. The same analogy can be made to a trade association relationship where the members are FICUs.

Membership Fees

Current NCUA regulations do not authorize corporates to charge members fees for membership. The proposal would explicitly permit corporates, going forward, to charge membership fees. If a corporate elects to charge such fees, it must provide each member with a minimum of six months notice of any new fees, recurring fees or any “material” change to an existing fee. Notably, a membership fee must be proportional to the member’s asset size. A corporate would be able to terminate the membership of a member that fails to pay the fee within 60 days of the invoice date.

NAFCU requests that one additional feature be added to this aspect of the proposed rule. Specifically, we believe the decision of whether to charge membership fees should rest with the corporate’s members. The proposal is silent in this regard; thus, we ask that the agency add a requirement that any corporate membership fee be approved by at least a majority of the corporate’s members voting.

Disclosure of Executive and Director Compensation from CUSOs

Pursuant to the September 2010 Corporate Rule, a corporate must annually prepare and provide its members with a document that discloses the compensation of certain employees. The final rule did not, however, address compensation received by a corporate employee from a CUSO.

The proposed rule would require the disclosure of a corporate employee’s compensation received from a CUSO in addition to the disclosure of compensation received from the corporate. NCUA would also require that a corporate’s contract with a CUSO requires the CUSO to disclose compensation paid to any employees that are also employees of a corporate lending to, or investing in, the CUSO.

Disclosure of employee compensation is understandably a sensitive issue for those whose compensation is disclosed. While we support providing corporate members with transparent financial records, including certain compensation information, the proposed rule on compensation disclosure is further evidence that NCUA continues to forge down the road of increased disclosure of compensation. In this regard, we strongly encourage NCUA to closely consider whether the benefits of each additional disclosure requirement the agency institutes relative to executive, director and other employee compensation outweighs the costs.

Recording of Votes by Corporate Boards

Current NCUA regulations do not require votes conducted by a corporate board to be recorded. Under the proposed rule, the minutes that report a vote must identify the board members, by name, who voted for or against a proposal, those who were absent, those who failed to vote, and those who abstained from voting. NCUA reasons that this requirement is necessary to increase the transparency of corporate board actions.

Similar to our comments regarding disclosure of corporate employee compensation, NAFCU generally agrees with the agency's goal of achieving the greatest transparency possible.

However, we are concerned that NCUA may be overreaching in this case, given the important fact that corporate directors are volunteers and it is in the best interest of both the corporate and the credit union industry that corporates attract and retain highly qualified directors. We are concerned that this proposal can, fairly or unfairly, easily dissuade qualified persons from filling an unpaid and volunteer role on a corporate's board. We believe that each corporate should determine whether to record votes, rather than being directed to do so by NCUA. Additionally, we believe the recently instituted restrictions on who can serve on a corporate's board, as well as other new rules concerning corporate governance, are adequate at this time.

As NCUA finalizes the proposed rule, we ask that it considers that a board of directors is a body. NAFCU believes that regulations that serve to dissect this body into individuals detract from this tenet.

Audit and Reporting Requirements

Next, the proposed rule would establish a number of new audit and reporting requirements.

Under the proposed rule, a corporate is required to prepare an annual financial statement that is audited by an independent public accountant (IPA). The financial statement must meet generally accepted accounting principles (GAAP) standards. In addition, a corporate must prepare an annual management report that must be signed by both the CEO and CFO (or chief accounting officer). Further, a corporate would be required to provide NCUA with a copy of its annual report, which must contain the audited financial statements, the IPA's report on those statements, the management's report, and, for corporates over \$1 billion in assets, the IPA's attestation report on management's assessment of internal control over financial reporting. NCUA will make the annual report publicly available.

The proposed rule also sets forth a number of new regulations applicable to a corporate's supervisory committee, especially as regards the committee's relationship with the IPA. Under the proposal, a supervisory committee may not contain employees

of the corporate and the members must be independent of the corporate. The duties of the committee would include appointment, compensation, and oversight of the IPA, in addition to the duties specified in the corporate's bylaws and other regulations. In fulfilling these new duties, the committee must ensure that audit agreements (including engagement letters) with an IPA do not contain certain limitation of liability provisions. Further, the proposal requires that the committee has access to its own outside counsel.

While, in principle, NAFCU agrees that the proposed audit and reporting requirements would benefit natural person credit unions by providing them with more relevant information as they make their business decisions relative to corporates, we are concerned that the benefits may not justify the costs associated with the new requirements, and believe NCUA should issue more guidance in this area in lieu of regulations. Further, we do not agree that corporates over \$1 billion in assets should be required to attain a separate report from the IPA on management's assertion concerning the effectiveness of the institution's internal control structure and procedures for financial reporting.

In regards to the proposed provisions relative to supervisory committees, NAFCU generally agrees that members of corporates' supervisory committees should be independent. The proposal, however, does not adequately define what constitutes "material business or professional relationships." In particular, it is not clear whether an officer of a NPCU would be disqualified if the officer's NPCU holds certificates in the corporate. We believe a clearer definition of the phrase is warranted and request that NCUA affords the public an opportunity to comment on such definition.

Enterprise Risk Management

The proposal would also add § 704.22 to address corporates' enterprise risk management (ERM) policies and practices. The new section would require a corporate to develop and follow an ERM policy. A corporate's board must establish an ERM committee, which would be responsible for overseeing the corporate's risk management practices and must report to the board at least annually. At least one independent risk management expert must be included in the committee. "Independent" would mean that the expert does not have any family relationship or material business or professional relationships with the corporate that would affect his or her independence as a committee member, and has been free of such relationship for at least three years.

NAFCU generally agrees with the proposed rules on ERM. We believe effective ERM policies and procedures are important for operating a corporate in today's environment.

We do, however, request two clarifications. First, we ask that NCUA clarify that the ERM expert can be outsourced. We believe that this is a reasonable option that corporates should be afforded. Second, we request that NCUA define the term "material

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business or professional relationship” as the term would apply to the proposed regulations on ERM.

NAFCU appreciates the opportunity to comment on the proposed rule. Should you have any questions, please contact Tessema Tefferi, NAFCU’s Associate Director of Regulatory Affairs, at (703) 842-2268 or ttefferi@nafcu.org, or me at (703) 842-2215 or fbecker@nafcu.org.

Sincerely,

A handwritten signature in cursive script, appearing to read "Fred R. Becker, Jr.", written in black ink.

Fred R. Becker, Jr.
President/CEO