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Delivered via email to regcomments@ncua.gov

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

Re: Marvin Umholtz Comments on Potential Voluntary Prepaid Assessments Program

Dear Ms. Rupp:

Based upon conversations with clients and colleagues, I recommend that the National Credit Union Administration (NCUA) Board not launch the proposed Voluntary Prepaid Assessments Program. I do not anticipate that many credit unions would participate in the voluntary program and I would certainly advise them not to do so. The NCUA Board has taken a number of difficult but necessary steps to resolve the corporate credit union crisis, but this proposed program does not measure up to the level of those prior actions. Under other circumstances the prepaid assessments program might have made some sense, but right now it looks like a square peg trying to fit into a round hole. The program's underlying concept is flawed, it is unlikely to succeed, and it will only be an unwelcomed distraction at a time when the agency's and industry's attention should instead be laser-focused on charter survival issues.

Credit Union Deposit Insurance Structural Reforms Needed
Moving forward with this ill-advised concept also runs the public perception risk of embarrassing the credit union industry by further exposing supervisory weaknesses. Comparing this proposal to what was done by the Federal Deposit Insurance Corporation (FDIC) obfuscates the huge structural and funding differences between the bank deposit insurance fund and the credit union deposit insurance structure. Those differences make the proposed assessment prepay program inappropriate for credit unions. The un-named stakeholders that the NCUA Board said it is being responsive to by floating this allegedly FDIC-like proposal at this time might have been well-intentioned, but the proposal is not at all like the FDIC program and should not be presented and marketed as such.

If the NCUA needs cash flow for the Temporary Corporate Credit Union Stabilization Fund (TCCUSF), it already has the authority to confiscate each credit union's 1% deposit in the National Credit Union Share Insurance Fund (NCUSIF) and require its replenishment as many times as necessary. The primary reason the agency is unlikely to do that is out of concern that it could trigger a cascading retail credit union failure scenario. That is a valid concern and therefore does not make for good public policy either. Rather than propose this distracting voluntary assessment prepayment program, the NCUA Board might make better use of its time and attention seeking needed reform of the credit union deposit insurance system's interconnected funding and at-risk capital structure.

Stabilization Fund Cash Flow Relief Insufficient Public Policy Rationale
In various documents the NCUA described the proposal as, "A plan for a program requested by stakeholders allowing voluntary prepayments of assessments in order to improve the liquidity of the Temporary Corporate Credit Union Stabilization Fund (Stabilization Fund)." The NCUA further stated, "Voluntarily prepaying future assessments would not change the ultimate cost of the corporate resolution plan. Rather, credit unions that elect to participate would help conserve capital and put the industry's substantial liquid balances in excess of $80 billion to good use. Maximum participation in the program could raise $2.8 billion, which would result in both a significant reduction of 2011 and 2012 assessments

and an additional reduction in the amount of funds borrowed from the U.S. Treasury by the Stabilization Fund."

Also, according to the NCUA, "After accounting for all proceeds raised through NGN [NCUA Guaranteed Notes] sales and monetization of other asset management estate assets, Stabilization Fund cash flow projections indicate a total of $8.44 billion in cash outlays will need to be funded through October 2012 with borrowed funds, assessments, and/or other alternatives. Use of NCUA's $6 billion borrowing authority through Treasury would provide the majority of the funding, but NCUA needs to maintain a margin against the borrowing limit for contingencies of at least $500 million. This leaves $2.94 billion in additional funding needed."

If the NCUA needs a loan to manage its cash flow, it should go to the U.S. Treasury for it – and if a $6 billion line of credit isn't enough, it should ask Treasury Secretary Timothy Geithner to declare an emergency extending the shared NCUSIF/TCCUSF credit line to $30 billion as already authorized by law. If that isn't enough then the NCUA leadership should go to Congress to get the authorization increased. Perhaps the NCUA fears that every incremental obligation to Treasury would come with too many strings attached – like external fiscal discipline and mandates on how to manage the TCCUSF and NCUSIF. The NCUA can and has in the past borrowed from its own Central Liquidity Facility (CLF) that has a $40 billion plus credit line, but under the current circumstances that is indistinguishable from borrowing directly from Treasury. With all of these alternatives available to the NCUA Board, the voluntary prepaid assessments program lacks sufficient urgency considering its unconvincing public policy rationale.

Credit Union Participation Makes Bad Business Sense

There are a number of strategic and public policy reasons why participating in the voluntary prepayment plan is a questionable idea, but the most compelling reason is that it makes bad business sense for each independent credit union. Any credit union that voluntarily prepaid would still have to pay regular assessments in 2011 and 2012, but starting in 2013 subsequent assessments would annually come out of the prepayment until exhausted. If the assessments are high enough in 2013 and subsequent years, the prepayment could be gone after just a few years. Any funds left in the credit union's prepaid account in June of 2021 would be returned, but until then the credit union could not get the money back or borrow against the NCUA loan asset. Locking up zero revenue for three or more years simply makes no sense for credit unions that should instead be remaining strategically nimble in the current volatile operating environment.

Since the cash flow needed for the TCCUSF in 2011-2012 is estimated to be equivalent to 38 basis points (bp) of insured shares (deposits), the current expectation is that the 2011 assessment will land in that 20-25 bp range. Annual TCCUSF assessments are anticipated through the life of the fund which sunsets in June of 2021, even if the voluntary assessment prepayment plan is implemented. The prepayment plan is designed to lower the front end impact of the TCCUSF cash flow needs on the stabilization assessments, but would not necessarily reduce the eventual losses from the corporate credit union legacy assets. Front-loading the costs versus back-loading or flattening the costs over the payback period comes with its own problems for credit unions.

No-Interest Loan to NCUA Contrary to SLY Principle

I can certainly understand why the NCUA would want an interest free loan from credit unions rather than have to pay to borrow from the U.S. Treasury. However, it is much harder to comprehend why a credit union board of directors would neglect its fiduciary duty to its membership and authorize a loan to NCUA that violated the SLY (Safety-Liquidity-Yield) principle. Although lending money to a federal agency is certainly safe (or at least one hopes that it is), voluntarily lending money to NCUA that is non-redeemable for up to ten years and that pays no interest is a glaring misalignment of both the L and Y in SLY. If a credit union is that eager to make a long-term no-interest loan, no doubt there are many deserving consumer members at each credit union who could benefit from such largesse.

The prepayment proposal caps an individual credit union's voluntary prepayment at 36 basis points of insured shares (deposits), that NCUA leaders repeatedly referenced during the NCUA's May 26th explanatory webinar as "not material." It might be harder to convince officials at credit unions that have been paying the special assessments for the TCCUSF and the annual NCUSIF premiums in recent years that such amounts are not material. Every dollar of unwelcomed expense or unrealized revenue is material to any credit union that still remains standing after the financial services system lockup, the residential housing meltdown, the corporate credit union crisis, and the still-myopic economic recovery.

Interest Rate Risk Embedded in Voluntary Prepaid Assessment Plan
The NCUA Board and state credit union regulators should also worry about the interest rate risk inherent in a credit union making such a non-earning assessment prepayment. The opportunity cost of giving NCUA a free loan might appear low today, but market rates have only one direction to go – and that is up. Although the near-term forecasts suggest that interest rates will remain relatively low, over ten years rates can change dramatically due to a wide range of political and/or economic events.

For example, back in October 1979 Paul Volker, then chairman of the Federal Reserve Board, decided to restrict the growth of the money supply. As a result of that action, short-term interest rates rapidly rose by more than six percent. Such a 600 bp interest rate shock in today's shaky economy and struggling net earnings environment could be disastrous for many credit unions. With the Federal Reserve System's asset-buying quantitative easing program scheduled to end soon amidst growing fears of stagflation, such a nightmare scenario could be plausible. It would appear that under many economic scenarios there could be serious potential for interest rate risk since a participating credit union would be locking in zero income on this non-redeemable loan to NCUA. Recently even the NCUA Board very appropriately cautioned credit unions about interest rate risk and it should not be encouraging risk-taking with this voluntary prepaid assessments program.

Additionally, although the NCUA leadership appears enthused about this voluntary prepayment proposal, have all of the state credit union regulators signed off on it? It would certainly be unfortunate for a state chartered federally insured credit union to voluntarily participate in this prepayment program and then have their state regulator justifiably chastise them for their bad judgment. Each state credit union regulatory agency should publicly state its position about this proposed prepaid assessment prior to any federally insured state chartered credit union's participation. Despite the pre-emptive authority given to the NCUA Board by the deposit insurance Title of the Federal Credit Union Act, this proposed voluntary prepaid assessments program's potential negative impact on safety and soundness should rightly be of significant concern to state regulators.

NCUA Board Should Withdraw the Voluntary Prepaid Assessments Program Proposal
For these reasons, the NCUA Board should withdraw its proposal for the Voluntary Prepaid Assessments Program and refocus its energies on other compelling credit union industry regulation and supervision problems – of which there are a multitude. The corporate credit union crisis with its unwelcomed consequences is unfortunately far from over and much remains to be accomplished by the NCUA Board in fully resolving it between now and 2021. The NCUA Board is also encouraged to seek reform of the credit union deposit insurance system's interconnected funding and at-risk capital structure.

Thank you for the opportunity to comment and I am prepared to elaborate should there be any questions.

Marvin U. 06/06/11

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Marvin Umholtz is President & CEO of Umholtz Strategic Planning & Consulting Services based in Olympia, Washington south of Seattle. He is a 35-year credit union industry veteran who has held many leadership positions with credit union organizations and financial services industry vendors during those years. A former association executive and lobbyist, he candidly shares his credit union industry knowledge and analysis with public policymakers, financial industry executives, and vendor companies. Umholtz also helps credit union boards and CEOs with strategic issues like growth, board governance, charter conversions, proactive mergers, voluntary liquidations, regulatory advocacy, and the growing conflict about the future role of credit unions in the financial services industry.