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June 20, 2011

The Honorable Debbie Matz
Chairman
National Credit Union Administration Board
1775 Duke Street
Alexandria, VA 22314-3428

RE: CUNA's Comments on NCUA's Voluntary Prepaid Corporate Credit Union Stabilization Fund Assessment Proposal

Dear Chairman Matz:

This letter represents the views of the Credit Union National Association regarding the agency's proposal to allow credit unions to prepay some of the Temporary Corporate Credit Union Stabilization Fund assessments on a voluntary basis. CUNA is the nation's largest credit union advocacy organization, representing about 90% of the country's 7,400 state and federally chartered credit unions which serve approximately 93 million members.

CUNA welcomes the agency's presentation of a plan to avoid severe front-loading of stabilization assessments. However, in all candor, the reaction from credit unions to date has been mixed. We believe there are several factors that have undermined greater support for the proposal, several of which we address more specifically below. First, some feel that NCUA should have developed such a proposal sooner to avoid having to make decisions on a rushed basis. In addition, there are those credit union officials who would like to pay all remaining assessments now in one year and those who want to spread out those assessments over many years. Further, the proposal is complex and not quickly understood, an important issue since credit union officials are very busy in this new era of heightened oversight and continued challenges created by the current economic environment. There are also specific concerns about whether the liquidity cushion is really needed and that there could be a free rider issue, depending on the level of credit union participation. Underlying all these issues is a general feeling of skepticism stemming from the agency's past communication about the corporate stabilization, its handling of some of the corporate credit unions prior to their conservatorship, examination issues, and overregulation.

Nonetheless, CUNA supports the concept of prepaid assessments, which we have urged the agency to consider, to allow credit unions to prepay some of their Corporate Credit Union Stabilization Fund assessments this year and to help even out assessments in future years. In that connection, the proposal

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the agency has issued for comments is positive and we commend the agency for seeking comments on a creative proposal.

We do have a number of recommendations for improvements to make the program more beneficial and appealing to credit unions to address concerns mentioned above, without undermining the payment of assessments or the Fund. CUNA comments were developed under the auspices of our Corporate Credit Union Next Steps Working Group that is chaired by VyStar President and CEO Terry West.

Background and How the Proposal Would Work

In 2009, Congress granted NCUA the ability to spread the costs of the Corporate Stabilization Fund over a seven year period. This was later extended to as much as eleven years, with the concurrence of the Treasury Department, with establishment of the Legacy Assets Plan in September of 2010. However, because of cash flow needs, the Fund requires more cash during the first three years than would be generated by assessments that would evenly spread the estimated $8.5 billion of remaining total Fund losses and expenses over the full eleven years. In the absence of a prepayment plan, NCUA has estimated that the 2011 and 2012 assessments would need to be approximately 25 bp and 13 bp of insured shares, respectively, raising a total of approximately $3 billion. That would leave approximately $5.5 billion to be collected over the remaining nine years, which would require an average assessment rate over those nine years of approximately 6 bp.[1]

To reduce the effect on credit union net income and capital in the first few years, CUNA, the leagues and many credit unions requested that NCUA meet some of the extra early cash needs of the Fund by treating some of the larger assessments of those early years as prepayments, to be expensed over a longer period. We suggested the agency use a procedure similar to that employed by the Federal Deposit Insurance Corporation (FDIC) in 2010. When faced with a similar liquidity issue, FDIC collected three years of deposit insurance premiums, treating two of those as prepaid expenses (asset purchases) that would be available for expensing as premiums in 2011 and 2012.

In establishing the voluntary prepay option, NCUA is of the opinion there are differences between the FDIC Act and the Federal Credit Union (FCU) Act

[1] $5.5 billion spread over 9 years would require an annual assessment of approximately $610 million. Assuming 5% annual growth of insured shares, collecting $610 million a year would require assessments of 7 bp in 2013 and 2014, falling to 5 bp in 2019, 2020 and 2021, averaging 6 bp over the full nine-year period. Of course, these annual collections may need to vary somewhat for other reasons, and the total amount to be collected will almost certainly be more or less than $8.5 billion, depending on the actual future losses on the legacy assets.

which render a mandatory prepayment approach impermissible for the Stabilization Fund. Therefore, the agency has presented the voluntary plan as a vehicle to achieve roughly the same effect, relying on a provision in the FCU Act that permits credit unions to make gifts to the Stabilization Fund. The gift in this case is not the prepayment itself, but the non-payment of interest on the prepaid assessments, which essentially become interest free loans to the Fund.

Under the program as presented by NCUA, credit unions could voluntarily prepay a portion of their future Stabilization Fund assessments that would apply in years 2013, 2014 and 2015. If there is substantial participation by credit unions, corporate stabilization assessments in 2011 and 2012 could be reduced to as low as 10 bp of insured shares. Below a certain level of participation, assessments would be reduced this year, but not to as low as 10 bp. The minimum prepayment per credit union would be $10,000, and the maximum would be 36 bp of insured shares as of March 31st. Also, under the proposal the minimum total participation level for the program to proceed would be $300 million.[2]

As we understand the proposal, assuming substantial participation by credit unions (at least half) a "fully participating" credit union would submit 46 basis points of cash to NCUA this year: 10 bp expensed as an assessment and 36 bp of prepaid expense (an asset purchase). Next year, that credit union would likely submit an additional 10 bp, expensed as an assessment. For approximately the following three years, the credit union would submit no additional cash, expensing the prepaid asset to cover assessments.

CUNA'S VIEWS

CUNA appreciates NCUA's proposal of a voluntary prepayment plan for corporate stabilization assessments to spread the expensing of assessments over time more effectively. The agency's plan is a sound and creative approach to address the legitimate needs of credit unions. However, CUNA has three concerns with the plan, which if addressed by the agency would make the plan much more effective for credit unions and thus more appealing to them without jeopardizing the stability of the Fund in any way. Following are some modifications CUNA is suggesting to the prepayment plan that we believe will address credit unions' concerns.

[2] With a total participation level of $300 million, the total of assessments in 2011 and 2012 could be reduced by about 4 bp. We assume that would lower the 2011 assessment to 21 bp, leaving the 2012 assessment at 13 bp. The $300 minimum has been suggested because below that level the short-term assessment reductions would not be worth implementing the program.

Free Rider Issue

The first concern stems from the voluntary nature of the plan. Because prepayments would not be required, only those credit unions that participate will bear the burden. However, all federally insured credit unions will benefit, regardless of whether they individually participate. This presents a classic "free rider" problem. The costs to a credit union that voluntarily prepays a portion of its future assessment are twofold: the loss of interest on the prepaid asset before it can actually be expensed, and the loss of control over the funds. Since the amount of the prepaid assessment would not be large (we assume an average balance of about 20 bp of assets over four years for a credit union participating at the full 36 bp level), and short- term interest rates are currently very low, the loss of interest income would not be large, but it could amount to a reduction of net income of between a quarter and a half of a basis point of assets in 2012, 2013, and 2014.[3]

The free rider issue exists because of the voluntary nature of the program. Because the agency believes the voluntary aspect is required by regulation, CUNA's suggestions are not to eliminate the free rider problem, but to lessen its negative effects.

NCUA should increase the size of the minimum participation threshold to $1 billion. At a total participation level of $300 million, the combined reduction in assessments in 2011 and 2012 would be only 4 bp. For a credit union contemplating maximum participation, the possibility of a 36 bp prepayment producing that small of an assessment reduction is not very attractive. Also, at 4 bp, it would probably not be worth implementing the program. At a minimum assessment level of $1 billion, representing about 1/3 participation from credit unions across the spectrum of asset sizes, the total assessment reduction would be about 13 bp, allowing assessments of 12 bp or 13 bp each year in 2011 and 2012.

NCUA should pay interest on the prepaid balance. Participating credit unions will incur an opportunity cost of reduced interest income. All credit unions benefit from smoothing assessments over time, and possibly a slight reduction in total assessments because of lower borrowing costs paid to Treasury if less of the Treasury line is used. This transfer of benefit from participants to non-participants could be lessened by paying a below-market interest rate on the prepaid balances. Keeping the rate below market (for example, 10 bp below the rate the Fund pays on the Treasury borrowing) would preserve the fact that credit unions would be providing a "gift" to the

[3] This assumes the prepayment is expensed in equal installments at the beginning of the third, fourth and fifth years; that insured shares grow 5% per year; and the Fed Funds rate averages 10 bp in the first year, 1% in the second, 3% in the third, and 4% in the fourth year. (These are not rate forecasts, just for explanatory purposes.)

Fund. It could either be explicitly paid to participating credit unions as interest, or treated as a credit applied to future uniform assessment charges.

Issues Relating to the Fund's Need for Liquidity

The second concern is NCUA's apparent intention to use the prepayment plan for two purposes: to help level the early-year assessments and to build an additional liquidity buffer for the Stabilization Fund. We strongly believe that only the first of these is an appropriate goal for this program.
The Helping Families Save Their Homes Act of 2009 established a $6 billion line of credit from Treasury for the Stabilization Fund. The agency appears to be prepared to use only $5.5 billion of that line on a routine basis, leaving $500 million "in reserve" for unknown future cash flow needs. CUNA understands and appreciates that intention, but believes this $500 million cushion is more than adequate to the task, and because of that cushion **no additional buffer is required.**

However, if credit union participation exceeds a certain level, the agency also intends to use a portion of the voluntary assessment prepayments to further bolster the liquidity of the Fund, over and above the $500 million cushion in the Treasury line of credit. In the handout prepared for a May 26, 2011 webinar on the program, the agency states: "At lower levels of total participation, the benefit will reduce 2011 assessments directly. At higher levels of participation, the funds may be used to reduce the level of borrowed funds—reducing interest cost—which would not equate to a dollar-for-dollar reduction in 2011 and 2012 assessments but an overall savings in resolution costs." Based on other information presented in the webinar, we understand this to mean that prepayments of up to an amount somewhere between $0.5 billion and $1.0 billion would be applied to reducing 2011 and 2012 assessments. However, beyond that level, prepayments would increasingly be used to reduce the amount of borrowing from Treasury (below $5.5 billion) rather than to reduce assessments as much as possible in the first two years.

CUNA does not believe that this additional liquidity should be part of the voluntary assessment program. It runs counter to the entire purpose of the Stabilization Fund, which is to spread the losses on the legacy assets over time, and it make the program more confusing. We also believe credit unions will have concerns with this element of the prepayment proposal, which could cause them to be less likely to participate in the plan. It would indeed slightly lower the total resolution costs of the Fund by lowering borrowing costs from Treasury. That benefit would accrue to all federally insured credit unions, regardless of whether or not they participate. However, it would do so at the expense of just those federally insured credit unions that do voluntarily participate, exacerbating the free rider issue.

The intended liquidity buffer of the program if participation is above a certain level is not a legislative requirement. Therefore, CUNA's strongly urges NCUA to eliminate it.

NCUA should clarify that prepayments will not be used to build an additional liquidity buffer. Using prepaid assessments for any purpose other than evenly spreading the expensing of assessments over time unnecessarily complicates the program, and makes it less attractive to credit unions considering participation. Stipulating that prepayments will not be used for any other purpose will substantially improve the program.

To ensure they are used only for their intended purpose, prepayments should be applied dollar-for-dollar to reduce 2011 and 2012 assessments until those assessments have been lowered to approximate even-spreading of the $8.5 billion expected expenses over the full eleven years of the program. That would imply assessments of approximately 10 bp in 2011 and 2012, which would be possible if voluntary prepayments totaled about $1.5 billion, a participation rate of slightly more than 50%.

In the event that total participation amounts to more than approximately $1.5 billion, the excess liquidity should be returned to participating credit unions simply by expensing the amount above $1.5 billion for this year's assessment on a pro rata basis.

If NCUA determines that the additional liquidity over $3 billion in the first two years is absolutely essential and justified, which we do not agree that it is, we urge the agency to inform credit unions of all the options it has considered for raising such liquidity. For example, some have suggested NCUA use the Central Liquidity Facility to provide a low-cost loan to the TCCUSF. We do not see that there are legal impediments to this approach, and we urge the agency to give this and other options that could provide liquidity, if needed, full consideration. We also urge NCUA to be as comprehensive as possible in explaining to the credit union system the options it has considered, including the reasons why they will work or why they are unacceptable.

Small Credit Unions Should Not Be Locked Out Of the Program

CUNA's third concern is the ineligibility of smaller credit unions. With a $10,000 minimum prepayment amount, the cutoff point for participation is approximately $3 million in assets. CUNA believes that credit unions of any size should be able to participate if they so desire. The only reason to exclude smaller credit unions would be if the extra cost to the Fund of processing their prepayments is substantial.

NCUA should change the minimum participation requirement to 10 bp of insured shares, regardless of a credit union's size. This approach would apply the same eligibility standard to all credit unions, regardless of size.

NCUA Should Provide Better Reporting ON the Legacy Assets and Prepaid Plan if Implemented

Largely because of their concerns about inadequate communications from the agency generally, a number of credit unions are very skeptical about the proposal. Including additional assessments to cover liquidity "concerns" of the agency that may not materialize only helps to underscore their uncertainty about NCUA's desire to help minimize costs to credit unions and manage the TCUSSF well. Eliminating the liquidity buffer from the proposal would help address this concern.

However, credit unions are also concerned about the lack of general, ongoing information about the TCCUSF, including the performance of the legacy assets. While some information about the TCCUSF is provided at NCUA Board meetings, we urge the Board to provide direct reports to credit unions and their advocacy organizations on a monthly basis about all material aspects of the Fund, including regular updates on the performance of the legacy assets. If the prepaid assessment program is adopted, we urge similar report regarding the program as part of the Fund's report.

Summary of the Effects of CUNA's Suggestions.

If the agency adopts all of CUNA's suggestions, credit unions contemplating participation could count on the following features of the program:

- Actual funding of a prepayment commitment would not be required unless there was sufficient participation from other credit unions to lower 2011 and 2012 assessments from 25 bp and 13 bp, respectively to 12bp or 13 bp in each of the two years. (The $1 billion minimum.)
- Given sufficient participation by credit unions (more than half), a portion of the prepayment might be used to cover 2011's assessment. (Capping prepayments at $1.5 billion.)
- Participating credit unions could expect a small return on the prepaid funds, either in the form of interest or credits against future assessments.
- All federally insured credit unions should be eligible to participate, regardless of size.
- All credit unions would have a better understanding of the agency's management of the legacy assets that were held by some of the corporate credit unions as well as the prepaid assessment program.

Closing

On June 13, NCUA's Deputy Executive Director Larry Fazio participated on an audio conference call with CUNA to further inform credit unions about the proposal and how it would affect their assessments. We offered the call at no charge and had about 725 lines participating on the call; we estimate even more credit union officials heard the call, and we appreciate Larry's participation. .

While credit unions and CUNA have a raised a number of concerns about agency actions on other issues, we recognize that NCUA has developed an innovative approach regarding prepaid assessments. Nonetheless, we think the program must be improved to fulfill its usefulness and attractiveness to credit unions. We urge the Board to adopt the recommendations addressed in our letter that will enhance the program and provide greater incentives for participation without undermining the Fund or the agency's control of it in any way.

Thank you for the opportunity to comment on the proposal. We can certainly be available to meet with you or any of the agency's staff if you would like to discuss our comments. Meanwhile, if you have questions about the letter, please do not hesitate to contact Bill Hampel at bhampel@cuna.coop, Mary Dunn at Mdunn@cuna.coop, or me at bcheney@cuna.coop.

Best regards,

Bill Cheney
President and CEO