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VIA E-MAIL TRANSMISSION
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September 28, 2012

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

Re: Maintaining Access to Emergency Liquidity
12 CFR Part 741, RIN 3133–AD96

Dear Ms. Rupp:

The Illinois Credit Union League represents over 375 federal credit unions and federally insured state chartered credit unions in Illinois. We are pleased to comment on the NCUA's proposed rulemaking on emergency liquidity.

NCUA intends to issue a rule requiring: (1) federally insured credit unions (FICUs) with assets under $10 million to maintain a written policy for managing liquidity and a list of contingent liquidity sources; (2) FICUs with assets $10 million or more to have a contingency funding plan for addressing liquidity shortfalls in emergency situations; and (3) FICUS with assets of $100 million or more to maintain access to a contingent federal liquidity source, in addition to having a contingency funding plan for addressing emergency liquidity shortfalls. The NCUA's proposed contingent federal liquidity sources are limited to (1) maintaining membership in good standing in the CLF, either directly or indirectly through a corporate credit union, or (2) establishing borrowing access to the Federal Reserve Discount Window.

NCUA Should Not Adopt an Emergency Liquidity Rule

As we stated in our February 2012 response to the NCUA's Advance Notice of Proposed Rulemaking (ANPR), we do not believe there is need for a rule regarding access to emergency liquidity.

The NCUA has not provided evidence of a need by the great majority of credit unions for an emergency federal liquidity source. The determination of whether a credit union needs to establish sources of emergency liquidity should be based on the credit union's size and its risk profile. While the NCUA states that unforeseen systemic liquidity events can render institutions "incapable of funding normal daily operations and facing a rapidly accelerating risk of operational disruption and even failure" and also refers to the "recent financial crisis and lingering concerns," the NCUA has not indicated that credit unions other than certain corporate credit unions suffered the above-described crisis.

Evidence of the historical lack of liquidity need by natural person credit unions is the history of the CLF. In the first 29 year of its existence, the CLF extended an average 18 loans per year of an average size of $3.3 million. (CLF's lending increased dramatically in 2008 and 2009 but almost all of those loans related to conserved corporate credit unions.)

Many of our FISCUs have complained on the seemingly constant stream of new regulations and proposed new regulations. New regulations should not be imposed unless there is convincing evidence that the regulation is proposed to address material safety and soundness issues. It appears that the development of new standards for liquidity was occasioned primarily because of weaknesses in institutions that relied heavily on wholesale funding in their business model. The NCUA should not require credit unions with ample liquidity, offering limited payment products, and with balance sheets not funded with wholesale deposits to establish new federally backed lines of liquidity.

A comprehensive interagency guidance on liquidity policies, plans and procedures took effect in May 2010. The guidance sufficiently addresses primary liquidity risk management issues and we note that the other financial regulators have not felt the need to propose liquidity regulations. We understand that banks are not required to establish a relationship with the Discount Window unless their examiners witness a deterioration that could raise material concerns about meeting depositor and market requirements or could cause a correspondent bank to limit the bank's clearing of payments.

We believe it would be more appropriate for the NCUA to use the banking regulators approach and determine which credit unions need to establish emergency lines of liquidity based on an analysis of the credit unions' level of brokered deposits, current levels of liquidity, payment system risk, and level of capitalization.

Suggested Changes if the NCUA Proceeds with the Regulation.

Proposed Minimum Asset Limits should be Increased.

The NCUA has proposed less onerous regulatory requirements for smaller credit unions. We believe the proposed under $10 million limit is too low. The NCUA is currently reviewing its definition of "small entity." The definition of smaller credit unions in the proposed rule should be the same as the NCUA's revised definition of "small entity."

The proposed regulation would require credit unions with assets of $100 million or more to maintain access to a backup federal liquidity source. The NCUA's supplementary information accompanying the proposed rule includes a chart providing credit unions' Emergency Liquidity Ratio (ELR) by asset class. The NCUA states that over the $100M asset threshold the ELR rises to a level that "suggests the need for demonstrated access to a source of emergency liquidity."[1]

However, a review of the NCUA's ELR chart indicates that ELR remains at approximately 4% to 4.2% for credit unions with assets of $70M to $150M and then rises to a 5% ELR for credit unions with assets of $250M. It seems more appropriate therefore, based on the ELR, to increase the asset level requiring maintenance of access to a backup federal liquidity source to $250 million. At $250M, the requirement would apply to approximately 11% of the 7,100 FISCUs, but the assets of those credit unions represent 77% of the total credit unions assets. A $100M threshold would almost double the number of credit unions subject to the requirement (from 750 FISCUs to 1,450 FISCUs) with a relatively small increase in covered assets (from 77% to 88%). Establishing a $250M asset threshold would result in the number of credit unions required to have a backup federal liquidity source being cut nearly in half, easing the operational burden for those 700 excluded credit unions. We believe the NCUA's objectives are still accomplished with this higher threshold.

Federal Home Loan Banks should be an Emergency Federal Liquidity Source.

In the Supplementary Information, the NCUA states that most commenters responding to NCUA's ANPR suggested that membership in a Federal Home Loan Bank (FHLB) should be an acceptable backup liquidity option. The NCUA responds that it believes FHLBs can provide valuable services to credit unions of all sizes and encourages credit unions to consider the merits of FHLB membership, but "the FHLBs are private institutions which are not obligated, and may not be able, to meet emergency liquidity demands in the same way the Discount Window and CLF are statutorily designed to do."

While FHLB's are owned cooperatively by over 8,000 commercial banks, thrifts, credit unions, and insurance companies, it is not accurate to describe them as "private institutions." The Federal Reserve Bank of New York Staff Report no. 357 on FHLBs (November 2008) states,

[1] 77 FR 44505 (July 30, 2012).

> The FHLB System is considered a government-sponsored enterprise (GSE) since it has been expressly created by an Act of Congress (The Federal Home Loan Bank Act of 1932) that includes several institutional benefits designed to reduce their operating costs…. Certain charter provisions combined with past government actions, have created a perception in financial markets that GSE obligations are implicitly guaranteed by the federal government.
>
> Special privileges accruing to the FHLB System include: a provision authorizing the Treasury Secretary to purchase up to $4 billion of FHLB securities; the treatment of FHLB securities as "government securities" under the Securities and Exchange Act of 1934; the statutory ability to use the Federal Reserve as its fiscal agent (like the Treasury); and an exemption from the bankruptcy code by way of being considered "federal instrumentalities".[2]

As GSEs, the FHLBs have access to capital markets in all economic circumstances and at rates on par with the U.S. Government.

The FRB staff report cited above also includes the FHLBs with the Federal Reserve System and the CLF as lenders of last resort (with the proviso that the real lender of last resort is the U.S. Treasury)--

> It is commonly noted that the structure of the current supervisory framework and safety net for U.S. financial institutions is antiquated and fragmented. The lender of last resort framework is no exception in that regard. Besides the Federal Reserve's Discount Window (and related liquidity facilities) and the FHLB System, there also exists the Central Liquidity Facility for credit unions (managed by the federal credit union regulator, the National Credit Union Administration) and the credit facilities provided by the U.S. Treasury to each of the three housing GSEs. Nevertheless, despite the institutional complexity of the existing lender of last resort framework, the ultimate lender of last resort is the U.S. Treasury and, by extension, the American taxpayers.[3]

The FHLBs' performance during the severe economic malaise commencing in 2007 indicates their ability to provide liquidity. During the crisis the amount of FHLB advances increase by 61% from $640 billion in the second quarter of 2007 to over $1 trillion by the third quarter of 2008. The FRB staff report states that while the Federal Reserve ultimately eclipsed the FHLB system in crisis-related lending to the financial system, the FHLB System remained "by far, the largest lender to U.S depository institutions while most of the Federal Reserve's liquidity operations have been for the benefit of non-depository or foreign financial institutions."[4]

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[2] Federal Reserve Bank of New York Staff Report no. 357, page 7.
[3] Federal Reserve Bank of New York Staff Report no. 357, page 29.
[4] Federal Reserve Bank of New York Staff Report no. 357, page 29.

We and our credit unions emphatically recommend that the FHLBs should be a permissible source of emergency liquidity for any credit union that has sufficient excess collateral so that even in adverse conditions it would meet FHLB collateral requirements for the amount of necessary emergency liquidity.

We believe the NCUA's concerns about emergency funding should be allayed if each FHLB provides assurances to the NCUA, formalized through a memorandum of understanding, that the FHLB can and will be able to provide emergency liquidity to eligible member credit unions.

<u>Changes in CLF Operations</u>
The CLF played an important role during the financial crisis as NCUA developed its course of action regarding corporate credit unions. However in the wake of the demise of U.S. Central Bridge Credit Union, recapitalization of the CLF by a by a significant number of credit unions, either directly or indirectly through their corporate credit unions, will be necessary for the CLF to continue to provide a source of liquidity.

CLF's previous policy of issuing its liquidity loans through the corporate credit unions and the capitalization of the CLF by U.S Central on behalf of credit unions that were members of corporate credit unions made the CLF virtually invisible to credit unions. It seems essential, therefore, that greater emphasis on education should be made by the CLF and that structural changes to the CLF should be made to ensure that credit unions find recapitalization desirable.

We suggest that this education should take the form of a Prospectus or a document similar to a Private Placement Memorandum, outlining the risks, benefits, structure, processes and details of capitalizing the CLF. It is also imperative that various operational aspects of the CLF should be improved to make it a truly functional emergency liquidity source.

Presently, it can take up to ten business days for a loan request to be funded by the CLF—an unacceptable time frame in any liquidity emergency. Changes to internal CLF funding, liquidity policies and loan approvals need to be made so that immediate access to emergency liquidity needs can be met by the CLF, including--

- Eliminating the requirement that agents, such as corporate credit unions, provide capital for all members. This is duplicative in many instances where a credit union already has Discount Window access. Corporates may than be able to provide capital for a subset of members, such as small credit unions.
- Granting limited designated authorities to agents or correspondents to speed processing.
- Allowing corporate credit unions to capitalize and borrow from the CLF directly.

While some of these changes may require legislation, we believe the changes would result in a CLF that would be a more viable option for credit unions. We believe that credit unions would prefer to have access to a source of emergency federal funding that is administered and self-supported within the credit union industry rather than relying solely on sources that have traditionally been bank oriented. We believe this approach is preferable to excluding the FHLB's as a source of emergency federal funding (which might be perceived by some credit unions as an attempt by the regulator to restrict legitimate competition with the CLF).

Applying Basel III Liquidity Measures

The NCUA Board has requested comment on the costs and benefits of applying Basel III liquidity measures and monitoring tools to FISCUs with assets over $500 million. We do not believe that formal use of these measures is prudent at this time. Basel III remains in flux. The measures have been designed to utilize a Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio that are not scheduled to come into effect until 2015 and 2018, respectively. We understand that in the banking regulators have recently considered adjustments to the LCR a full two years ahead of implementation. In addition, the Basel III liquidity measures were not developed with any consideration of the unique nature, structure or characteristics of credit unions. We urge the NCUA to refrain from imposing the Basil III liquidity measures or similar requirements on credit unions.

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We appreciate the opportunity to respond to NCUA's proposed rule on maintaining access to emergency liquidity. For the reasons stated above, we believe (1) a rule requiring all FICUs to maintain access to emergency federal liquidity sources is unnecessary for operational or supervisory purposes; (2) if the NCUA does mandate access to emergency liquidity in certain cases—(a) the minimum asset level should be at least $250 million; and (b) the Federal Home Loan Banks should be included as an appropriate source of emergency federal liquidity; and (3) the CLF should be maintained and its operations should be modernized to in order to attract recapitalization and compete with the operations of the Federal Reserve Discount Window and the FHLB. We will be happy to respond to any questions regarding these comments.

Very truly yours,

ILLINOIS CREDIT UNION LEAGUE

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