CORPORATE CREDIT UNION GUIDANCE LETTER

No. 2011-02 DATE: February 8, 2011

SUBJ: Large Consolidation Issues

TO: The Corporate Credit Union Addressed:

Corporate credit unions and their members continue to work collaboratively in developing appropriate business plans to ensure continued service under the new regulatory framework established in Part 704 of the National Credit Union Administration's ("NCUA") Rules and Regulations. This letter is intended to provide guidance to questions and issues raised by some corporate credit unions and their members as they work through this process.

Many parties envision consolidation among corporate credit unions as a necessary phase to achieve long-term viability in the corporate system. Others are considering the creation of credit union service organizations (CUSOs) to provide specific services to credit unions without the full array of services normally offered by a corporate credit union.

Many business models build on the concept that concentrating greater numbers of credit unions with a corporate credit union or specialized CUSO promotes efficiencies through economies of scale and improves long-term viability to the system. However, the concentration of services or the aggregation of service volumes in one entity large enough to introduce systemic risk may create an unacceptable "too big to fail" scenario. Among the problems such a scenario would create, the following concerns would be of critical significance:

- First, the impact of an interruption of service. An operational issue at an entity that causes a service interruption to large numbers of credit unions not only poses risk to those credit unions and their members, but has the potential to introduce reputation risk to the entire credit union system. Plans should include appropriate measures to eliminate the risks that large scale service interruptions may cause.

- Second, the impact of the actual failure of an institution. If a corporate credit union or CUSO were to fail, would there be an adequate contingency plan to ensure uninterrupted service to a large number of credit unions and an orderly transition to alternate service providers? An appropriate plan should provide sufficient detail to ensure members and services would be transitioned to other providers, without interruption of service, in the event of a failure.

In either case, without an adequate contingency plan, the larger number of credit unions seeking a new service provider in a very short period of time could overwhelm the capabilities of alternate service providers and result in service disruptions.

Recently, NCUA stepped in to ensure continued services to credit unions through the conservatorships at several corporate credit unions. This clearly is not an optimal long-term solution. The extended agency intervention at four corporate credit unions has succeeded in providing stability of operations, but the agency is not a long-term backstop solution nor should it develop a business model for credit unions. Future agency action to provide such systemic support cannot be factored into contingency plans. Additionally, NCUA's focus as Conservator is to maintain the status quo and avoid any service interruptions. The focus by NCUA on short-term viability does not foster innovation which is a key to long-term viability.

A business plan must not only focus on the current financial and technological landscape, but must also address long-term future viability. Corporate credit unions have historically operated with very thin profitability. The issue of profitability is one of the reasons a number of corporate credit unions introduced greater levels of risk to their balance sheets to offset costs of services. Going forward, an entity that will primarily be a service provider must be able to demonstrate the ability to safely generate adequate income not only to maintain existing services and the operational systems and staffing to deliver them, but must also adequately fund for identifying risks and for ensuring operational security and stability in the future. The capability for testing to identify and address any system weaknesses is critical to mitigate the risk of service interruptions.

All of these issues are difficult enough during normal business operations. The issues become even more complicated during any consolidation process. Not only do the plans need to take into consideration the various operational facets that must come together appropriately for a successful final result, they must also include reasonable action plans to ensure service continuity during the consolidation process.

In considering an appropriate business model, corporate credit unions and their members should evaluate the potential risks with the model they propose and determine if it meets their threshold for risk. Once the potential risks are identified, the business model should set forth the policies, procedures, and actions that will be taken to mitigate the potential impact. Every business plan will have its own unique risks that must be appropriately addressed.

I encourage you to consider these issues as you work towards finalizing your business plans. If you have any questions, please contact your district examiner or this office.

Sincerely,

Scott A. Hunt
Director
Office of Corporate Credit Unions

cc: State Regulators
ACCU
CUNA
NAFCU
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bcc: Reading
CFS Bean
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