CUFSLP
CALLAHAN CREDIT UNION FINANCIAL SERVICES LIMITED PARTNERSHIP

August 25, 2014

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

Re: Proposed Rule on Asset Securitization

Dear Mr. Poliquin:

As General Partner of Callahan Credit Union Financial Services LLLP ("CUFSLP"), we appreciate the opportunity to convey our thoughts, concerns, and suggestions regarding the National Credit Union Administration's ("NCUA's") Proposed Rule on Asset Securitization issued for comment in the June 26, 2014, *Federal Register* ("Proposed Rule").

As we understand it, the NCUA's intent for the Proposed Rule is to provide credit unions more flexibility and additional tools for managing liquidity and interest rate risk. This is a positive and constructive step that we fully endorse. Unfortunately, we believe that the Proposed Rule as currently written will not accomplish these objectives.

This letter comprises two sets of specific observations. The first covers the reasons we believe this initial proposal is of no practical value to the credit union movement and its member-owners despite the best of intentions. The second offers alternative approaches in the same vein that would accomplish the NCUA's apparent objective.

Reasons the Proposed Rule does not provide any practical new authority to credit unions.

1. The Proposed Rule does not permit credit unions to meet the demands of the primary large-scale buyers of securitized loans. CUFSLP research into the securitization of credit union assets establishes that an economically viable securitization program requires the guaranteed issuance on a regular basis of large blocks of securities backed by homogenous assets. Specifically, an issuing entity would need to be able to offer a minimum of $150-$200 million of homogenous loans at least once a quarter – an absolute minimum of $600 million per year.

   NCUA data indicate that in 2013, fewer than 100 credit unions originated more than $600 million annually in new loans ***total***. Only a literal handful of credit unions generated more than $600 million in non-agency mortgages. In other words, only one or two credit unions would be able to use this new authority – as proposed – as a tool for managing interest rate risk and liquidity.

2. The structured finance market is significantly impaired in the wake of the Great Recession. Very few transactions of any description are taking place because the failure of Trustees to protect the interests of senior debt holders during and after the meltdown has made the risk-reward balance unattractive. This limits the potential for traditional

securitization deals of any size. For new authority to have value to credit unions, it would have to provide the ability to address these issues. The Proposed Rule does not do this.

3. In theory, and if all other issues (such as volume, homogeneity, and the ability to guarantee production and delivery) were resolved, the superior quality of credit union assets might help overcome some of these limitations. In practice, that would require credit enhancements to ensure investors that they will reap the benefits of higher quality. The most widely recognized and cost efficient credit enhancement is a "buyback" or "substitution" provision, which the NCUA recognizes as "implicit recourse" and prohibits in the Proposed Rule. We understand the rationale, but believe it would handicap credit unions unnecessarily and urge the NCUA to revisit this outright ban.

Alternatives to the Proposed Rule that would meet NCUA objectives of enhanced liquidity management and effective interest rate risk management.

1. Allow the aggregation of loans to permit the creation of homogenous loan pools large enough to be securitized in a cost effective manner. The market demand for large transaction size is acknowledged implicitly in 12 CFR 701.23(b)(1), the NCUA grant of authority to purchase loans to create pools large enough for resale to the secondary market on a whole loan basis. Because of the additional complexity and cost associated with securitization, offering size is an even greater imperative in the securitization space.

   (We respectfully disagree with the assertion that the risk associated with acquisition for securitization is "uncharted." Securitization involves new risks, but the Proposed Rule itself implicitly addresses these. The risk attributable to loans purchased from other federally-insured credit unions for the purpose of assembling securitization pools would be related to the retention of up to 25% of such pools by issuing credit unions, but this risk is not new. It is fundamentally the same as the risk associated with the purchase and retention of loans as explicitly authorized at 12 CFR 701.23(b)(2)(i). The only difference is that credit unions are exposed to 100% of the credit risk associated with loans they purchase and retain, but no more than 25% of the credit risk associated with loans they would purchase and securitize.)

2. Allow credit unions to collaborate on the securitization of assets by permitting the creation of special purpose vehicles that are cooperatively owned by multiple credit unions. This would reduce, if not completely obviate the need for any single credit union to purchase loans to create securitization pools of adequate size for cost effective deals. In addition, it would allow credit unions to distribute the significant cost of establishing an issuing entity (which CUFSLP research has found to be at least $20-30 million depending on capitalization requirements). It would also allow credit unions to share the recurring costs associated with each securitization (which CUFSLP research has found to be roughly $1 million plus 45 basis points for each issuance).

3. Allow demonstration or pilot projects to enable the credit union movement to acquire the skills and demonstrate the abilities necessary to participate effectively in the secondary market. CUFSLP research has identified a number of demonstrative requirements for becoming a sustainably successful secondary market issuer. Specifically, credit union-

supported issuers would have to be able to assemble and deliver large pools of homogenous loans on a repeated and guaranteed basis or the market will not be responsive to credit union offerings.

Unfortunately, CUFSLP research has further determined that a number of secondary market opinion makers do not believe credit unions generally, or the credit union movement collectively, is capable of meeting these requirements. Until this misperception is proven wrong through demonstrative performance, no secondary market purchaser will be prepared to do business with credit unions on terms that are economically attractive to credit unions and their member-owners.

To meet the requirements identified by CUFSLP research, a demonstration project would comprise:

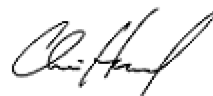
- Aggregation of pools of homogenous loans from multiple originators.
- Separation, distribution, and servicing of shares or slices of such pools.
- Ability to do these things on a repeated and guaranteed forward-flow basis.

Such a project would be a complex effort requiring a small group of credit unions to work cooperatively to reach agreement on loan underwriting and manufacturing and on guaranteed delivery and purchase. CUFSLP research has determined that until a series of such transactions is completed successfully on at least a small scale, no viable outside buyer would be prepared to guarantee purchase of assets – even on a pilot basis – at a price that would be economically viable for participating credit unions.

In summary, customers drive markets. Authority to enter a market is meaningless if not accompanied by the authority to meet the needs and expectations of customers – in this case, the buy-side investors to whom credit unions would be selling securitized loans. Because the Proposed Rule does not empower credit unions to meet investor demands, its new grant of authority is of no practical use. Of particular note is the requirement of volume enforced by both buy-side expectations and costs. This alone means that without the authority for credit unions to collaborate in some fashion to aggregate loans, securitization authority will not be of any practical value to the credit union movement and its member owners.

Thank you for the opportunity to comment on the Proposed Rule. We are pleased that the NCUA is working affirmatively to provide credit unions with more tools to manage interest rate risk and liquidity and thereby meet the needs of their member-owners. With this in mind, we respectfully request the revision of the Proposed Rule to permit credit unions to collaborate and otherwise align with the characteristics and requirements of the secondary market. We believe these changes are necessary to enable credit unions to realize the benefits the NCUA identified as the reasons for offering this Proposed Rule.

Sincerely,



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