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Gerard Poliquin, Secretary of the Board
National Credit Union Administration
Via email: regcomments@ncua.gov

RE: Comments on Proposed Rule – 12 CFR Part 704 – Corporate Credit Unions

First Carolina Corporate Credit Union (FCCCU) appreciates the opportunity to provide comments to the NCUA Board regarding proposed changes to 12 CFR Part 704. FCCCU is a $1.4 billion corporate credit union serving credit unions primarily located in North and South Carolina. Approximately 90% of credit unions in the Carolinas invested permanent capital in our organization so we have a strong vested interest to ensure that our operating environment is focused on maximizing both safety and value for our member credit unions.

FCCCU agrees with all of the proposed changes which include revisions in the following sections: 704.2 Definitions, 704.3 Corporate Credit Union Capital, 704.5 Investments, 704.6 Credit Risk Management, 704.7 Lending, 704.8 ALM, 704.9 Liquidity Management, 704.11 Corporate CUSOs, 704.14 Representation, 704.15 Audit Requirements, 704.18 Fidelity Bond Coverage, 704.21 Enterprise Risk Management, Appendix A Model Disclosures Forms, Appendix B Expanded Authorities, and Appendix C Weighted Assets.

However, we do have several comments and recommendations to improve the regulation and allow corporate credit unions to more effectively meet their members' investment, liquidity, and payment service needs. These recommendations focus on being able to expand services to credit unions without increasing risk exposures.

<u>704.2 Definitions: Tier 1 Capital</u>
As referenced earlier, a majority of credit unions within our core membership invested in the new permanent capital instrument, Perpetual Contributed Capital (PCC), to enable FCCCU to continue providing critical investment, liquidity, and payment services to them at cooperative prices. PCC is defined in the regulation as perpetual, non-cumulative dividend accounts that are available to cover losses exceeding retained earnings and are considered

tier 1 capital and a form of equity under generally accepted accounting principles, or GAAP. They are permanent capital instruments for a corporate credit union funded by its member credit unions. This type of capital is the regulatory equivalent of non-cumulative perpetual preferred stock as defined by the FDIC regulations, which is consistent with the definitions of "Tier 1" or "core capital" by the banking regulator, the Securities Exchange Commission and the United States Treasury.

Currently, Regulation 704 defines Tier 1 capital appropriately as the combination of retained earnings and PCC with a few minor adjustments. However, the regulation begins to alter the definition of Tier 1 capital to exclude some portion of PCC (704.2 Definitions, Tier 1 Capital paragraphs 8 &9) in late 2016. These sections reduce the amount of PCC that can be counted as part of Tier 1 capital starting in October 2016 and then more severely in October 2020 despite the fact that they remain as perpetual forms of capital for the corporates. Credit unions that invested in PCC at their corporate did so to ensure that they would continue to receive competitively priced investment, liquidity, and payment services from their corporate well into the future. No other financial regulator fails to include any portion of permanent capital or non-cumulative perpetual preferred stock or other similar permanently contributed capital into the calculation of core capital. Deducting portions of PCC from Tier 1 capital does nothing to reduce risks, it only serves to negatively impact a corporate's regulatory capital which thereafter will differ from GAAP capital.

Therefore, ***<u>we believe strongly that under the definition of Tier 1 capital (section 704.2) paragraphs 8 and 9 should be deleted from the regulation</u>.*** We are not advocating any changes in the capital thresholds currently written in the regulation. Although the only minimum retained earnings ratio specifically stated in the existing regulation is 0.45% as of October 2013, the calculation of tier 1 capital in October 2016 and October 2020 require minimum retained earnings ratios (1.0% by October 2016 and 2.0% by October 2020) to meet the minimum tier one capital ratio requirement .

In addition to the overall fairness in treatment of PCC as a permanent investment and part of a corporate's core capital, there are numerous negative operational impacts to corporates from the regulatory deductions of PCC from Tier 1 capital. A major negative consequence of the reduction of PCC is how third parties that we rely on to manage our businesses -- Federal Reserve Banks, credit rating agencies, creditors, financial institution business partners, public news agencies, and auditors -- view our capital strength. Most have indicated that they look at regulatory capital as opposed to GAAP capital since our ability to operate is based on our regulatory capital levels. Every corporate will see its Tier 1 capital levels and ratios drop significantly in October 2016 and even more dramatically in October 2020 despite the fact that our overall capital will be much stronger due to years of building retained earnings to exceed the required capital thresholds. We do not view the

PCC deductions as beneficial to our operating environment or to our ability to provide services to the credit unions that capitalized us so we could operate at maximum effectiveness. The deductions also do nothing to improve the risk exposures or asset quality of a corporate, they simply drop the appearance of capital strength within the corporate system based on the treatment of a capital instrument that differs from the way every other financial regulator treats this type of permanent capital.

Section 704.9 Liquidity Management

We commend NCUA for extending the maximum borrowing limit from 30 days to 120 days, however, ***we believe the limit should be extended to one year for seasonal borrowing and three years for matched term funding for member credit unions*** to allow corporates an important tool in managing interest rate risk while providing member credit unions the ability to borrow on a term basis. Most large credit unions today have access to term funding through the Federal Home Loan Bank (FHLB) system, however, the majority of credit unions under $100 million in assets are not FHLB members and many do not qualify for membership. These credit unions' most reliable liquidity source for funding, overnight or term, is generally their corporate credit union. The request for longer term funding for corporates would allow us to better serve credit unions by giving us the option of match funding term loans as needed to minimize our interest rate risk in these transactions. Protracted seasonal liquidity needs and systemic liquidity scenarios often extend well past 120 days as we experienced during the recent financial crisis. We anticipate liquidity to tighten as the economy continues to improve while loan demand is expected to outpace deposit growth at credit unions. In addition, payment processing dollar settlement requirements continue to rise which could put further pressure on tightening liquidity as will rising interest rates. Borrowings at corporate credit unions could easily become a regular occurrence and key cash management vehicle for credit unions. Corporate credit unions should have as many tools at their disposal as possible to assist the credit union system's liquidity demands. Corporate credit unions should be able to pre-position liquidity in anticipation of an expected long-term liquidity event and/or match fund member credit union term borrowings. Securing term funding in advance of an expected liquidity event is considered a best practice for liquidity management.

Section 704.7 Lending -- Central Liquidity Facility (CLF) "Bridge Loans"

Corporate credit unions have been working with the Central Liquidity Facility for the past several years in an attempt to better position the credit union system to obtain funding as needed through the CLF. Every corporate has agreed to serve as a correspondent for the CLF, meaning corporates will administer the collateralization of CLF funded loans to ensure the CLF is only loaning funds to its member credit unions on a secured basis. The CLF funds its loans by accessing funds available to it from the Federal Financing Bank, however, the Treasury can take upwards of 5-10 days to fund the loan advance requests from the CLF. Bridge loans would therefore have a maximum term of 10 days. As another critical role for corporates in assisting credit union liquidity needs, we would ***request that the regulation specifically exempt "CLF bridge loans" (similar to CLF guaranteed loans) from regulatory lending limits to credit unions and add to Section 704.2 a definition of a CLF Bridge Loan as a loan funded by a corporate for a term of not more than 10 days to a credit union that has been approved for an advance from the CLF and is waiting for the CLF funds to be available***.

Section 704.5 Investments
Agency mortgage-backed securities have always represented an important asset class for corporate credit unions as well as natural-person credit unions. We understand that GSE mortgages securities are currently being re-structured and may no longer meet the definition as defined in the Federal Credit Union Act since some form of credit sharing with investors and/or originators may be required in future deals. Although we do not have any current recommendations in this area since it is still being defined, we simply ask NCUA to monitor this asset class to be able to take appropriate regulatory action as needed to make sure credit unions and corporates are not shut out of this new emerging government mortgage securities market.

Thank you for the opportunity to comment on the proposed changes to 12 CFR Part 704 – Corporate Credit Unions.

Sincerely,

David Brehmer
President/CEO
First Carolina Corporate Credit Union