Tricorp Federal Credit Union

January 5, 2015

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

Tricorp Federal Credit Union (Tricorp) appreciates the opportunity to provide comments to the NCUA Board regarding proposed changes to 12 CFR Part 704. Overall, we concur with all of the proposed changes which include revisions in the following sections: 704.2 Definitions, 704.3 PCA, 704.5 Investments, 704.6 Credit Risk Management, 704.7 Lending, 704.8 ALM, 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. We do appreciate the additional flexibility that is being proposed in Sections 704.7, 704.8 and 704.9. However we do feel that there are some additional areas that could improve the regulation and allow corporate credit unions to better provide critical investment, liquidity, payment, and other services to the credit union community. We view these recommendations as an opportunity to improve our ability to serve our members without increasing risk exposures.

704.2 Definitions: Tier 1 Capital

Perpetual Contributed Capital (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. These 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 regulatory, the Securities Exchange Commission and the United States Treasury.

Therefore, ***we believe strongly that under the definition of Tier 1 capital (section 704.2) paragraphs 8 and 9 should be deleted from the regulation.*** 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.

One major unintended consequence of the reduction of PCC that can be included as part of Tier 1 capital is how third parties, Federal Reserve Banks, credit rating agencies, creditors, financial institution business partners, and auditors, that we rely on to manage our businesses view our capital strength. Most will look at regulatory capital as opposed to GAAP capital since our ability to operate is based on our regulatory capital. 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 our ability to provide services to the credit unions that capitalized us to ensure we could operate at maximum effectiveness.

704.2 Definitions & 704.8(h): Weighted Average Life

A corporate, per the rule, is to manage their financial assets to maintain, at month end, a WAL of 2 years or less in the base case, and 2.25 years in a slowing prepayment speed test. U.S. Government issued or guaranteed securities (section 704.8 (h)) are allowed special benefit in the rule, and the WAL for this type of security is given a one-half WAL treatment.

If the goal of the WAL measure is to control interest rate risk, then WAL is not the correct measure as it does not distinguish between fixed and floating rate instruments. A duration methodology would be more appropriate to measure interest rate risk. The current rule already has clear and concise interest rate risk tools in the NEV limitations.

Alternately, if WAL was designed as a credit risk indicator or developed to shorten investment lives to address credit risk, then why would government securities have a WAL figure associated with them? A clear example of the shortcomings of this rule as an interest rate risk or credit risk measure is as follows: a corporate with a balance sheet comprised of NCUA Guaranteed Notes specifically NGN 2010-R3 2A, a one-month Libor floating-rate note priced at 100-30 for a discount margin of one-month Libor + 34 basis points and has a 7.00% interest rate cap. In the base case this note has a 4.25-year WAL, so even with a 50% WAL treatment, a portfolio comprised of this note plus sufficient cash for liquidity, would violate the WAL limitation, despite having no credit risk and very limited interest rate risk. These and other government issued or guaranteed securities exhibit no credit risk and are very liquid in the marketplace. With regards to NEV, the current rule already provides parameters which measures impairment which ultimately limits interest rate risk exposure a corporate may operate under.

WAL is at best a credit risk comparison tool, and is not an interest rate risk measurement tool. The use throughout the rule of weighted average life (WAL) creates the unintended consequence of potentially encouraging risk taking by providing an incentive not to purchase government securities. Although the 50% reduction in WAL for government bonds is intended to compensate for the lack of credit risk in this sector, it is often not sufficient to compensate for the difference in yield for a comparable security that contains credit risk. This incentivizes a portfolio manager to accept additional credit risk. Therefore, a portfolio manager would choose a riskier credit instrument with the higher yield (such as an auto ABS) over a longer dated government issue.

We are not recommending that the NCUA Board revise the WAL measurement for credit related securities, NCUA Rules and Regulations Part 704.8(f) and Part 704.8(g), but we are recommending an exclusion of government guaranteed securities from this risk measurement in NCUA Rules and Regulations Part 704.8(h).

Requested Solution. We respectfully request the section 704.8(h) be modified to address the fact that it is good policy and the desire of the NCUA Board to encourage the purchase of government securities and further that government securities be considered to have a WAL of zero in regards to the WAL test. Further, we ask that all ABS securities comprised of collateral issued or insured by the US government, or one of its Agencies, be provided a WAL treatment similar to government securities, up to the portion of the collateral that is guaranteed.

Section 704.9 Liquidity Management

We do appreciate the proposed extension for the maximum borrowing limit from 30 days to 120 days, however, ***we believe the limit should be extended to one year and three years if the borrowing is matched to a member term loan.*** This would be to provide corporates with an important tool in managing interest rate risk while providing member credit unions the ability to borrow on a term basis. Our larger members 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 term funding is for the most part their corporate credit union. The request for longer term funding for corporates is so we can better serve credit unions by allowing us to match fund term loans as needed to minimize 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. Lending at credit unions in our region has been very strong and credit unions have been experiencing the tightest liquidity in many years. It is expected that loan demand will outpace deposit growth at credit unions at least for 2015 which will further tighten liquidity within the credit union system. 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 its disposal as possible to assist the credit union system's liquidity demands. Corporate credit unions should be able to preposition 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.

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 US Treasury, however, the Treasury can take upwards of 5-10 days to fund the loan advance requests from the CLF. As another critical role for corporates in assisting credit union liquidity needs, we would ***request that the Liquidity section of the regulation specifically authorize corporates the ability to provide "CLF bridge loans" above regulatory LOC limits to credit unions that have been approved for advances from the CLF but are simply waiting for the CLF funds to be available***. Bridge loans would therefore have terms of no longer than 10 days.

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

Sincerely,

Stephen A Roy

Stephen A. Roy
President/CEO

Cc: Tricorp FCU Board of Directors