Arizona Credit Union League
& Affiliates

March 24, 2009

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

Dear Ms. Rupp:

Thank you for allowing the credit union movement the option to comment on the future of corporate credit unions. The Arizona Credit Union League appreciates the opportunity to comment on NCUA's Advanced Notice of Proposed Rulemaking for Part 704 (hereinafter "The ANPR"). The League, which has served the credit union movement for 75 years, represents fifty-four (54) credit unions of various sizes within the state of Arizona. In an effort to determine how our credit union members felt about the ANPR, we assembled a small group of credit union CEO(s) and senior management to form a task force to discuss this matter. The comments and remarks presented in this letter are the thoughts and suggestions that resulted from the discussion of this task force.

## I. <u>The Role of Corporate Credit Unions</u>

### A. *Payment Systems*

Under the current corporate system, payment system services are combined with other functions such as settlement services and investment services. The goal of the corporate network is to provide convenient, efficient, and affordable services for credit unions of all sizes. We do not support the creation of separate payment system and investment silos within corporate credit unions. If payment systems were separated from investment services, this would lead to an astronomical increase for natural person credit unions. The earnings from the investment arm support the payment systems function and make it possible for corporate credit unions to offer cost-effective payment and settlement services to natural person credit unions. To separate the investment services function would require that the payment systems function have its own separate capital and reserve requirements.

The payment systems structure is a complex structure that requires extensive support staff, including technical staff because of advancements in technology. The corporate network acts as a distribution channel to provide services to natural person credit unions. If U.S. Central is eliminated, a key piece of this channel is eliminated, the piece that allows retail corporate credit unions to obtain volume pricing for natural person credit unions. This only leads to increased costs for credit unions. Additionally, if NCUA eliminates retail corporate credit unions, NCUA eliminates local, personal service for natural person credit unions. Service related issues

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would be left to U.S. Central depriving credit unions of the hands on service they have grown to expect. In Arizona, credit unions are fortunate to have the option to belong to a corporate credit union that provides sophisticated payment system services that serve both small and large credit unions in an efficient manner. Without these services, credit unions would be forced to turn to local banks at a significantly higher price. We see no reason to disturb the current system.

B. *Liquidity Management*

Liquidity is and should continue to be viewed as a critical function that corporate credit unions provide. We support the continuation of corporate credit unions providing liquidity to natural person credit unions. Natural person credit unions, particularly small and medium credit unions, look to corporates to provide liquid investments and to provide borrowing ability. Without this core function, credit unions would have no alternative but to seek these services outside of the credit union system. This not only jeopardizes the credit union movement, but is particularly troublesome for those credit unions who have limited or nonexistent mortgage portfolios. Many credit unions would have no access to outside sources of liquidity, such as the FHLB. It is unrealistic to think that credit unions will be able to obtain borrowing arrangements outside of the credit union network without incurring astronomical costs. It is not reasonable to expect credit unions to obtain a borrowing relationship in this current environment. In an environment where credit markets are frozen, the need for liquidity is especially great, particularly for small and medium sized credit unions. We do agree that liquidity should be strengthened, but removing the corporate credit union's ability to provide liquidity is not the prudent course of action.

A viable option for credit unions to obtain liquidity is to access the Central Liquidity Facility (CLF). Too often, fear of adverse publicity and the negative connotations associated with the CLF deters credit unions from viewing this as a viable and wise option. If the stigma could be removed, more credit unions would access the Central Liquidity Fund.

C. *Field of Membership*

The ANPR suggests that the decision to allow a national field of membership for corporate credit unions resulted in increased risks to the corporate system. The ANPR further asks whether field of membership should revert back to a state or regional field of membership. We could not disagree with this more. We fail to see the connection between national field of membership and increased risks. Any connection is tenuous at best. The power to determine which corporate credit union to invest in should rest solely within the hands of natural person credit unions. Credit unions are aware of the amount of risk they are able to absorb and can choose corporate credit unions that fit their needs. To place restrictions on this ability would destroy any semblance of competition, hamper innovation in the marketplace, and severely limit investment choices.

Furthermore, we fail to see how this change would lead to efficiency in the system. NCUA would have to promulgate new regulations, which would take time and resources away from matters that are far more pressing. Instead of having various investment options, credit unions would be forced to invest in the same state or regional corporate credit unions. How does this decrease risk? This would certainly lead to an overwhelmed corporate system unable to meet the needs of its credit unions.



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D. *Investment Authority*

The ANPR suggests removing or reducing a corporate credit union's expanded investment authority. We do not believe these measures are necessary. Expanded investment authority did not lead to U.S. Central's losses. If a corporate is adequately capitalized, there is no reason to limit investment powers. Perhaps the ability to invest in so-called riskier investments must be preceded by a risk-based capital requirement. Rather than tinker with a corporate's investment authority, a risk-based capital approach should be implemented to address credit risk. This will minimize credit risks in the corporate system. Credit unions routinely manage risk everyday as they make loans directly to consumers who are more sensitive to economic conditions. Likewise, it should be left up to corporate credit unions to manage their own risk

E. *Structure: Two-tiered system*

We believe that the current two-tier system should be maintained. To do away with this system does not really address the root cause of where credit unions are today. This is neither efficient nor does it ensure that natural person credit unions are accorded the same level of customer service and support, product choices, and investment offerings. Additionally, one has to consider the cost savings that natural person credit unions receive from being part of the current corporate system. It is unrealistic to think that credit unions are going to obtain these same benefits in the open marketplace. The wholesale corporate credit union and retail corporates each serve a purpose in the system-they are not one in the same. One suggested action is to centralize technology under U.S. Central and keep regional corporate credit unions in place as a delivery channel, regional credit union advocate, and service provider.

As far as whether the transfer of risk is inappropriate, we do not believe that this is a critical issue. Each part of the system bears some level of risk, from the wholesale corporate credit union down to the natural person credit unions.

## II. Corporate Capital

A. *Core Capital /Membership Capital/ Risk-based Capital*

NCUA should certainly consider revising its approach to corporate credit unions and capital requirements. Corporate credit unions not only need to raise more capital, but also explore other methods to raise capital. Currently, corporate credit unions are being held to accounting standards that do not fit the unique structure and framework of the credit union system. It is our suggestion that corporate credit unions be required to utilize a risk-based capital approach to monitor, control, and mitigate credit risk. The current capital system contains three types of capital: membership capital, paid-in capital, and reserves and undivided earnings.

We suggest basing membership on Tier-1 capital participation. It makes sense to limit services to only those credit unions who are members of the credit union. This not only raises capital, but also motivates natural person credit unions to become a part of the network.



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## III. Permissible Investments

We see absolutely no rational justification to prohibit or limit the investment powers of corporate credit unions. The expansion of powers **did not** lead to the problems that exist today. To correlate the expansion of investment powers or to somehow infer that improper investment decisions led to U.S. Central's losses does not take into account the fact that the investments, particularly the mortgage backed securities, were primarily AAA rated. No one predicted the collapse of the real estate market. To limit investment powers now would be an ill-timed measure that does not benefit corporate credit unions. A risk-based capital system would allow those corporate credit unions who are adequately capitalized to invest however they see fit.

## IV. Credit Risk Management

It is clear that the rating system is flawed, but other than the three major rating agencies (Moody's, S&P, and Fitch) there is no viable alternative being proposed at the moment. One possible option is to require a dual rating by the various rating agencies. If an investment's rating was lowered by both agencies, the investment would be out of compliance. We are not in favor of revising the current regulations to set specific concentration limits nor are we in favor of forcing corporates to obtain an independent evaluation of credit risk. This is neither efficient nor realistic. As mentioned above, there is no viable alternative out in the marketplace to assess credit risk. What model would NCUA use? There are no assurances that the chosen model would be any more reliable than the ratings set forth by the major rating agencies.

## V. Asset Liability Management

We do not support additional regulations requiring corporates to perform modeling and stress testing. Many corporates already perform various levels of modeling and stress testing. This really just monitors interest rates risk, not credit risk. To require specific testing will use additional time and monetary resources, which is certainly not cost-effective or efficient. NCUA is proposing a failed model to fix the corporate system. It is difficult to perform a stress test on the widening of the credit spread. There is no history to define or guide corporate credit unions. Any testing is likely to be subjective depending on who is conducting the test. How will NCUA develop a standard to evaluate corporate credit unions? A viable alternative is to implement a risk-based capital system that addresses credit risk combined with the current NEV testing that addresses interest rate risk and eliminates the need for additional stress testing.

## VI. Corporate Governance

Generally, we do not support establishing additional standards for corporate board of directors. NCUA suggests adding minimum educational and experience standards. Again, this action has little bearing on whether a corporate credit union succeeds or fails. Board members who have passion for the movement and integrity come from various educational backgrounds and possess differing experience levels. To implement minimum standards would limit the pool of talented board members unnecessarily. Board members lacking in education and experience did not contribute to the current financial landscape. That said a viable option that we are in favor of is requiring that each board of directors contain a natural credit union person from each asset size



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level. This will serve as a reminder that corporate credit unions exist to serve natural person credit unions. However, **we still do not believe this should be a regulatory requirement.** Corporate credit unions are able to revise their bylaws to implement this change if they feel it is beneficial.

We do not support requiring corporate boards to have directors that are unrelated to the credit union movement. Although we do believe this could be a positive option resulting in a board that is diverse in background and knowledge, this should be up to each individual corporate credit union to determine if such a move is beneficial. Similarly, with respect to term limits, we again feel it is up to each corporate credit union. NCUA should not dictate this by implementing additional regulations. Credit unions should be able to retain quality board members for as long as those board members are able to serve.

We are vehemently opposed to allowing any corporate board member to be compensated for their time and service to the board. Not only is this a slippery slope leading to compensation for natural person credit union board members, but it does not enhance the quality of the board. We believe this is contrary to the essence of the credit union movement. From an advocacy standpoint, this distinguishes credit unions from banks. This type of action could undermine the integrity and philosophy of the movement.

Finally, a move towards transparency of compensation is not supported. This moves us one step closer to the for-profit model of banks and other financial institutions. Once again, this undermines the essence of the credit union movement and is inappropriate for corporate credit unions. Additionally, it is the board of the corporate credit union, not NCUA, who is in the best position to determine if the efforts of senior management are commensurate with their compensation.

Thank you for the opportunity to share our thoughts and offer our suggestions. Corporate credit unions play a vital role for credit unions, both large and small. Not only do they offer integral services at a reasonable cost, but they also provide solid investment options for credit unions. Additionally, corporate credit unions play a role in the financial services industry as they represent credit unions' interests to the Federal Reserve System and the banking industry. Natural person credit unions rely on the expertise of corporate credit unions, particularly small credit unions that are unable to afford in-house support. They rely on their corporate's knowledge and background to assist with maintaining their credit unions and meeting their member's needs. A strong, diverse corporate system promotes a strong network of natural person credit unions beneath it. To dismantle the current system would adversely affect not only the corporate network but natural person credit unions and their members.

Sincerely,

Scott Earl, President/CEO
Arizona Credit Union League & Affiliates



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