Denver Community Credit Union
In Denver, For Denver

Thursday, March 26, 2009

The Honorable Michael E. Fryzel
Chairman
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

The Honorable Rodney E. Hood
Vice Chairman
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

The Honorable Gigi Hyland
Board Member
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428

Dear Chairman Fryzel, Vice Chairman Hood, Board Member Hyland,

In response to the Advance Notice of Proposed Rule Making (ANPR) regarding the potential restructure of the corporate credit union system, the management of Denver Community Federal Credit Union respectfully submits the following comments.

<u>Payment System Proposals</u>

1. Should payment system services be isolated from other services to separate the risks?

a) If so, what is the best structure for isolating these services from other business risks?

Response: No. Natural person credit unions (NPCUs) should be able to rely on a cooperative business system model instead of turning to an outside industry (banking) for payment system services. This would most likely result if these entities are separated and thereby increasing the overhead costs for these services.

2. Should there be a charter that strictly limits corporates to operating a payment system only?

Response: No. Other business models that currently provide payment system alternatives to credit unions are often more costly to credit unions and don't align themselves as well with the industry. These alternatives require more cash management and staff time for NPCUs as we would not have the availability of sweep accounts or settlement accounts. Intra-day funding rules, which corporates manage today (corporates cannot run an intra-day negative balance without facing significant penalties and strict oversight from the Federal Reserve Bank) would apply to NPCUs and managing those activities would require more staff time.

3. Is there sufficient earnings potential in offering payment systems to support a limited business model that is restricted to payment systems services only?

Response: No. It is our understanding that corporates are providing payment systems at a break even, if not a loss, as a point of convenience to obtain investment and settlement dollars. The current cooperative model generates revenue through investments, not through payment system services.

Denver Community Credit Union
In Denver, For Denver

Liquidity and liquidity management proposals

1. What steps should be taken, and by whom, to preserve and strengthen corporates' ability to offer liquidity services?

Response: Liquidity management is primarily the responsibility of NPCUs management and board of directors. Corporates provide emergency back-up to NPCUs if liquidity cannot be self-managed and the CLF to corporates if liquidity cannot be self-managed at that level. This system worked until recently. This liquidity freeze has been the result of an ill conceived accounting practice called FAS 157 which forces unrealistic recognition of possible losses. This rule stopped many institutions with cash from purchasing securities because this rule required those securities to be marked artificially lower after acquisition as the market continued to be frozen. If NPCUs would have been able to self fund, and maintain deposits in the Corporates, or if the markets would not have dislocated leaving securities undervalued, or if the NCUA would have removed the requirement to record securities under FAS 157 (creating a GAAP/RAP difference) there would not have been a liquidity problem and the questions in the ANPR would not have been required.

2. Should the NCUA consider limiting a corporate's ability to offer other specific types of products and services in order to preserve and defend the liquidity function?

a) What specific types of products and services should corporates be authorized to provide?

Response: No. NCUA should be committed to maintaining parity between the current regulators. Part of this requires that credit unions are made available similar and commensurate business models and authorities as our competitors. NPCUs should not be forced into seeking and paying for services from an industry (banking) which are subject to the same economic risks as credit union and who have the stated goal of putting NPCUs out of business.

3. Should the NCUA add aggregate cash flow duration limitations to Part 704?

a) If so, describe how this requirement should be structured, and also identify how such limitations would benefit liquidity management.

Response: No. While there may some benefit to including these limitations into the business model projections of both corporates and NPCUs, codifying any limit into regulation ignores the uniqueness of the institution and the strategy developed by the board and management. Only through an analysis of the limits within the specific organization can the opportunity to identify certain unintended consequences.

b) What cash flow duration limits would be appropriate for corporates particularly in an evolving interest rate market with previously unseen credit risk spreads?

Response: Obviously, current economic conditions are working to set the new standard for a financial institutions ability to withstand additional stresses. It would be dependent on the individual organization to structure its balance sheet to withstand the newly realized magnitude of these risks.

Field of Membership Issues

1. Should the agency return to defined FOMs to address what they perceive as risk associated to expanding FOM?

Response: No. The ability of a NPCU to join multiple corporates has worked to maintain competitiveness in a cooperative industry. We are not aware of organizations that have not been subject to the same economic stresses by virtue of their limited field of membership requirements (i.e. FHLB System). Additionally, we do not support any requirement for NPCUs to capitalize any corporate which utilize corporates for investment purposes.

Expanded Investment Authority

Currently, Part 704 provides an option by which corporates meeting certain criteria can qualify for expanded investment authority.

1. Does the need for expanded authorities continue to exist?

a) If so, should NCUA modify the procedures and qualifications by which corporates currently qualify for expanded authorities?

Response: Yes. There is currently a need for expanded authorities to exist. Corporates should be permitted to invest into areas not available to NPCUs to better diversify the risk associated with these investment alternatives. NCUA could quickly and effectively modify its qualification standards by requiring additional capital or liquid reserves of those corporates applying for that authority.

b) If so, what should the new standards be?

Response: The greater the authorities, the greater the capital requirements. The greater the risks taken, the greater the capital required. In no case should credit unions be more restricted than their competitors. If credit unions are required to move to their capital standards or the standard included in BASEL, then similar investment authorities should be permitted.

2. Should NCUA reduce the expanded authorities available?

a) If so, which ones?

Response: No, in fact, corporates may need additional authorities to counter the concentration of risk currently experienced. The ability of credit unions to effectively diversity beyond the mortgage industry (and others), can only work to manage the risks associated with an entire portfolio. It's counterproductive to assume that sector risks can be eliminated through the reduction of available investment options.

3. Alternatively, should any of the limits in existing expanded authorities be reduced or increased?

a) If so, which ones?

Response: As noted above, increased authorities should follow increased capital standards despite the greater flexibility to manage risk. Additional investment alternatives should be considered to avoid concentration in particular areas.

4. Once granted, should NCUA require periodic requalification for expanded authorities?

a) If so, what should be the timeframe?

Response: Annually. Although more costly for corporates, a more frequent recertification schedule is obviously less expensive than the alternative.

Structure: two-tiered system
The corporate system is made up of two-tiers: a retail network of corporates that provide products and services to NPCUs, and a single, wholesale corporate (U.S. Central) that exclusively services the retail corporates.

1. Does the two-tier corporate system in its current form meet the needs of credit unions?

Response: Currently yes. In the future, US Central could be reduced to a liquidity aggregator and thereby realign the risks associated with generating investment income back to the retail corporates. We do not support the concept of a "super-corporate."

2. Is there a continuing need for a wholesale corporate credit union?

a) If so, what should be its primary role?

Response: US Central's role should be limited to that of a liquidity aggregator.

3. Should there be a differentiation in powers and authorities between retail and wholesale corporates?

Response: No. The wholesale corporate is owned and operated by corporates as a credit union service organization. That CUSO was formed to support the collective needs of its owners utilizing cooperative principles. This governance model is appropriate and works to set the appropriate differentiation in powers and authorities.

4. Does the current configuration result in the inappropriate transfer of risk from the retail corporates to the wholesale corporate?

Response: NPCUs have not been made aware of anything inappropriate. If so, we would also like to know why the regulator's existing authorities and powers are insufficient to address a known problem. It is our understanding that the regulator has the authority to require additional capital when additional risks are detected.

5. Should capital requirements and risk measurement criteria (e.g., NEV volatility), be different from those requirements that apply to a retail corporate credit union?

Response: No. These are simply tools used to manage in a safe and sound manner. Capital requirements should always be coordinated with the risks detected in an organization.

Corporate Capital
NCUA is considering revising various definitions and standards for determining appropriate capital requirements for corporates. These changes would bring the corporate capital requirements more into line with standards applied by other federal financial regulators. Another issue under consideration is whether to require a certain level of contributed capital from any natural person credit union seeking either membership or services from a corporate.

Core Capital
Under the current rule, core capital is defined as retained earnings plus paid-in capital.

1. Should the NCUA establish a new capital ratio that corporates must meet consisting only of core capital, and if so, what would be the appropriate level to require?

Response: NCUA should continue the use of RUDE plus paid in capital, however, the NCUA should also include non-GAAP qualified capital as part of the capital ratio and not distinguish between types as the rating agencies currently do. Until the non-qualified paid in capital meets its expiration term limitation, the NCUA would charge that capital account for any loss exceeding RUDE and GAAP qualified paid in capital and before charging Member Capital Shares.

Denver Community Credit Union
In Denver, For Denver

Risk based capital (as has been suggested several years ago and declined by the NCUA) should be reconsidered. It appears the NCUA is moving to a BASEL standard, however, caution is required, because BASEL organizations have many more authorities than corporates. Holding corporates to the same capital levels, without permitting them to have the same level of authorities, will lead to underperformance and disintermediation.

2. What actions are necessary to enable corporates to attain a sufficient core capital ratio?

Response: The NCUA should permit corporates to obtain outside or secondary capital, but would require the NCUA to also permit, non-CU directors to sit on Corporate Boards. The NCUA should also support including all paid in capital as core capital and assist corporates in converting term PIC to GAAP-qualified PIC.

3. What would be an appropriate time frame for corporates to attain sufficient capital?

Response: If capital standards are increased, sufficient time must be permitted so as not to create an unfair disadvantage to NPCUs during the capital growing phase. Estimates of Net Income, currently the only source to build capital based on the current economic environment, are required to determine how soon it is feasible to achieve the new standards. The insurance guarantee should be extend long enough to build capital through earnings and subsequent capital infusions from NPCUs.

4. What is the appropriate method to measure core capital given the significant fluctuation in corporate assets that occur?

Response: Risk-based capital would assist corporates in managing based on the NPCU's liquidity needs. As a liquidity provider, and a cooperative, corporates must be able to grow and shrink the balance sheet to meet members' needs.

5. What is the correct degree of emphasis that should be placed on generating core capital through undivided earnings?

Response: The higher the requirement for RUDE, the less competitive NPCU members will become because net income is the only way for corporates to increase RUDE. NCUA must consider all capital and stop distinguishing between levels. As we've seen recently, all capital is at risk.

6. Should there be a requirement that a corporate limit its services only to members maintaining contributed core capital with the corporate?

Response: No. This works to limit competitiveness between corporates and reduces the investment alternatives (by way of additional requirements) for NPCUs.

7. Offer any other suggestions or comments related to core capital for corporates.

Response: NCUA should require the same terms and conditions for all paid in capital.

<u>Membership Capital</u>

1. Should the NCUA continue to allow membership capital in its current configuration, or should the agency eliminate or modify certain features, such as the adjustment feature, so that membership capital meets the traditionally accepted definition of tier two capital?

Response: Yes. All capital should be included in minimum requirements. Allowing MCS type capital to grow and shrink with NPCU balance sheets may be very beneficial for the system in times of tight liquidity. NPCUs need to have some flexibility.

Denver Community Credit Union
In Denver, For Denver

2. Should adjusted balance requirements be tied only to assets?
Response: Yes, and consistently applied.

3. Should the NCUA impose limits on the frequency of adjustments?

Response: The business model of each corporate should determine the need for capital accounts and the frequency of possible adjustments.

4. Should the agency require that any attempted reduction in membership capital based on downward adjustment automatically result in the account being placed on notice, within the meaning §704.3(b)(3), so that only a delayed payout after the three-year notice expires is permissible?

Response: No. It is the role of the Board and management of any credit union to determine the need for capital to support the business model. In the event a capital payout would cause an unsafe or unsound operating environment the Agency has adequate supervisory tools to fix that problem.

5. Should there be a requirement that any withdrawal of membership capital be conditioned on the corporate's ability to meet all applicable capital requirements following withdrawal?

Response: No. This requirement is not consistent with a cooperative business model.

Risk-based capital and contributed capital requirements

1. Should NCUA consider risk-based capital for corporates consistent with that currently required of other federally regulated financial institutions?

Response: Yes. However, if investment or other authorities are restricted, then capital requirements should be commensurately lower.

2. What regulatory and statutory changes, if any, would be required to effectuate such a change?

Response: A line by line contrast and comparison of balance sheet items and their associated risks would be required so as not to put corporates and their NPCU members at an unfair disadvantage to for-profit banks.

3. Should a natural person credit union be required to maintain a contributed capital account with its corporate as a prerequisite to obtaining services from the corporate?

Response: No. This works to limit competitiveness between corporates and reduces the investment alternatives (by way of additional requirements) for NPCUs.

4. Should contributed capital be calculated as a function of share balances maintained with the corporate? What about using asset size?

Response: NCUA should allow various approaches to meet each corporates business model. These are contractual arrangements between NPCU's and Corporate Credit Unions.

Permissible Investments

NCUA is considering whether the corporate investment authorities should be constrained or restricted. Presently, corporates have the authority to purchase and hold investments that would not be permissible for natural person FCU members under Part 703 (or, in some cases, outside of what is authorized for a state chartered credit union).

1. Should the NCUA limit corporates' investment authorities to those allowed for NPCUs?

Response: No. This action would substantially reduce ability of a corporate to diversity its portfolio and mitigate risks assumed by NPCUs. Concentration of risks would result and subject the industry to additional losses during a downturn.

2. Should the NCUA prohibit certain categories of, or specific, investments?

Response: No. This action would substantially reduce ability of a corporate to diversity its portfolio and mitigate risks assumed by NPCUs. Concentration of risks would result and subject the industry to additional losses during a downturn.

Credit Risk Management

1. Should the NCUA limit the extent to which a corporate may rely on credit ratings provided by Nationally Recognized Statistical Rating Organizations (NRSROs)?

Response: No. It's unreasonable to assume that an institution can limit its reliance on a credit rating agency without having to assume the costs associated with developing the rating system independently. This would be substantially cost prohibitive and does nothing to address the underlying lack of accountability of these organizations.

2. Should the NCUA require more than one rating for an investment, or require that the lowest rating meet the minimum rating requirements of Part 704?

Response: Yes. The ability to review the outputs of various models in different scenarios is highly beneficial, however this requirement would have done little (if anything) to prevent the issues faced today.

3. Should the NCUA require additional stress modeling tools in the regulation to enhance credit risk management?

Response: Yes.

4. Should Part 704 be revised to lessen the reliance on NRSRO ratings?

Response: No. NRSROs should be regulated as closely as financial institutions and have the same standards for accountability.

5. Identify any other changes that may be prudent to help assure adequate management of credit risk. Considerations should include whether Part 704 should be revised to provide specific concentration limits, including sector and obligor limits.

Response: The NCUA must take care not to overly restrict authorities. Adequate risk diversification is the first step in a well-managed portfolio; any regulation should provide flexibility to adjust diversification limits to meet economic and financial market conditions.

6. What specific limits would be appropriate for corporates?

Response: This is impossible to answer without determining the needs of the member credit unions. Risks can be assumed insofar as they do not pose an unnecessary threat to capital and provide meaningful value to the NPCUs. Each credit union board is responsible for identifying the risks associated with specific concentrations and sectors and documenting these in policy. NCUAs role is to determine compliance with these policies.

7. Should corporates be required to obtain independent evaluations of credit risk in their investment portfolios?

a. If so, what would be appropriate standards for these contractors?

Response: Yes. However, there should be no requirement to duplicate these standards internally.

8. Should corporates be required to test sensitivities to credit spread widening, and if so, what standards should apply to that effort?

Response: Yes. These stresses should be modeled after existing regulations related to NEV modeling.

Asset Liability Management

Under past rules, the NCUA required corporates to perform net interest income modeling and stress testing. The agency is considering re-instating that requirement in light of the current market. Alternatively, the agency may consider some form of mandatory modeling and testing of credit spread increases.

1. Should the NCUA require corporates to use monitoring tools to identify these types of trends, including specifically comments about tangible benefits, if any, which would flow from these types of modeling requirements?

Response: Yes. Increased testing and modeling is always beneficial.

Corporate Governance

1. Should the NCUA require that a director possess an appropriate level of experience and independence?

Response: Yes, however, the appropriate level of experience and independence should be determined by the board of directors and documented in a policy outlining those requirements. This is not the role of the regulator.

In a cooperative system, independence is not desirable. Additionally, boards have the ability to retain outside expertise for the purpose of making strategic decisions; however, they should not have the ability to place those experts in board positions.

2. Should the agency set term limits, allow compensation for corporate directors, and requiring greater transparency for executive compensation?

Response: Term limits should be decided by and are the responsibility of the board of directors. NCUA should examine compliance with these policies, not decide what they should be.

Compensation for corporate directors is not desirable in a cooperative, not-for-profit system and would do little to attract “talent” into these groups.

As for transparency of executive compensation…the NCUA already has the authority to inspect and monitor compensation for all credit union employees. The act of making these figures public does absolutely nothing to address the issues facing the corporate system today or in the future.

3. Is the current structure of retail and wholesale corporate credit union boards appropriate given the corporate business model?

Response: Yes. Cooperatives should be led by the members who utilize the services of the cooperative who have a stake in the success of the institution.

4. Should NCUA establish more stringent minimum qualifications and training requirements for individuals serving as corporate credit union directors?

a. If so, what should the minimum qualifications be?

Response: Minimum qualifications and training requirements should be decided by and are the responsibility of the board of directors. NCUA should examine compliance with these policies, not decide what they should be.

5. Should the NCUA establish a category of “outside director,” (persons who are not officers of that corporate), officers of member natural person credit unions, and/or individuals from entirely outside the credit union industry?

a. Should the NCUA require that corporates select some minimum number of outside directors for their boards?

Response: No. While corporate boards may have the need to retain specific expertise in these positions, it should not be a requirement of the regulator.

6. Should U.S. Central be required to have some directors from NPCUs?

Response: No. While representation of NPCUs on US Central’s board may be desirable, it should not be a requirement of the regulator.

7. Comment is also sought on whether corporate directors should be compensated, and, if so, whether such compensation should be limited to outside directors only.

Response: Compensation for corporate directors is not desirable. This is an important distinction between the credit union movement and the for-profit financial services industry that should be maintained.