Georgia Credit Union Affiliates 1934-2009 75th Anniversary
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April 2, 2009

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

Dear Mary:

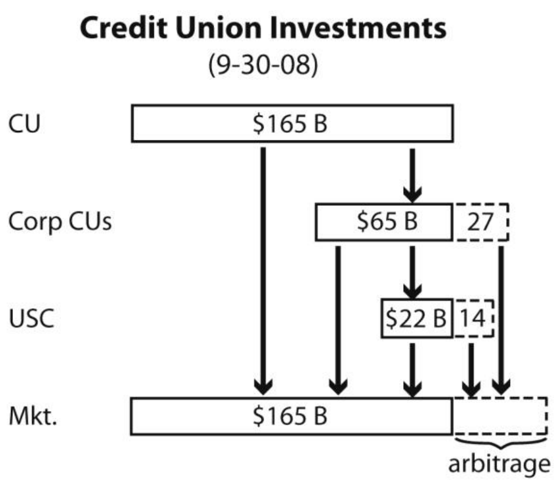
We appreciate the opportunity to submit our thoughts in response to the Advanced Notice for Proposed Rulemaking that deals with matters affecting the future of the Corporate Credit Union System. What follows are remarks that represent the collective views of the Georgia Credit Union League Board of Directors. In addition to these remarks, the League has encouraged individual credit unions and Georgia Central Credit Union to offer their views under separate cover.

Over three decades, U.S. credit unions have received substantial benefits from the corporate credit union system. <u>The primary benefits have come from services designed to help credit unions settle remote access transactions, invest surplus funds and obtain affordable access to wholesale sources of credit</u>. In addition, the corporate network has extended benefits to include a host of payments-related support services. Unlike the Federal Reserve System or the Federal Home Loan Bank System, the Corporate Credit Union Network was designed and built in the private sector. Its stakeholders have come to include virtually all credit unions and their support organizations. The Corporate Credit Union Network is arguably the most extensive (and successful) example of credit union collaboration to be found anywhere in the credit union world. How the system is "restructured" matters to all of us.

We are experiencing the third significant period of financial stress for the Corporate Credit Union Network. The first was in the early 1980's during extraordinary spikes in inflation and interest rates. The second occurred in the backwash from the banking/S&L crisis of the late 1980's – early 1990's. This period included the Cap Corp liquidation. The third, of course, is the present "situation". <u>The common element in all three periods of stress is that corporate credit unions found themselves holding performing (but devalued) assets with substantially longer maturities than the corresponding deposit/liability duration</u>. What's new about our present situation is that the securities held by U.S. Central and several corporate credit unions have been devalued by different circumstances…mortgage/credit market meltdown versus rapidly escalating interest rates during the first two periods of stress.

Debate is now centered around how to stabilize the loss exposures at U.S. Central and the corporates. The fundamental solution will have to be the same as it was in the first two periods of stress…that is, to provide funding so that the performing assets can pay out over time…or; have their value restored by improved market conditions. Cap Corp was the unnecessary exception. The present anxieties are related to NCUA's proposal for causing immediate recognition of all potential (liquidation scenario) costs on credit union income statements during 2009. Like others, <u>we believe that there are alternatives to the massive, one-shot bottom line shock</u>.

It might be helpful to characterize the dimensions of the Corporate Credit Union Network. Using September 30, 2008 Call Report data, we estimate that U.S. credit unions had approximately $165 billion of investable surplus. At the time, about $65 billion was invested in the obligations of corporate credit unions. The rest was invested directly in U.S. Treasury/Agency debt, bank obligations and assorted asset-backed securities. In turn, corporate credit unions invested about $22 billion in the obligations of U.S. Central. The rest of corporate surplus was invested "around the U.S. Central balance sheet." U.S. Central, of course, invested most of its assets into market obligations. Pictorially, the Corporate Credit Union Network on 9/30/08 looked something like this:



Over recent years, corporate credit unions have been engaged in intense competition for attracting surplus from credit unions. As can be seen above, the largest source of competition has been coming from "off-balance sheet" investment alternatives…primarily U.S. agency securities and insured bank CDs. In addition, credit unions have been able to "shop" a number of corporate credit unions for the best rate…often moving large balances for a basis point or two. In this environment of intense competition, mortgage-backed securities (either direct or through U.S. Central) provided the highest yields without sacrificing quality (most were rated AAA) or liquidity (the secondary markets were huge and efficient). Or, so we thought. It turns out that corporate credit union investment portfolios were built "within the 100-year flood plain." Hindsight is always 20-20. <u>It is clear now that corporate credit unions had inadequate capital to reside these mortgage-backed securities on their balance sheets…not so much for default risk, but for cash flow (liquidity) risk</u>.

- Capital Adequacy -

Our thoughts for reform begin with capital adequacy. In our view, corporate credit union capital should consist of RUDE (reserves and undivided earnings) and PIC (perpetual paid-in capital). For the first three decades, natural person credit unions were expected to have much higher levels of capital than corporate credit unions…and corporate credit unions were expected to have higher capital than U.S. Central. Leverage increased dramatically. We think that this concept needs to be reversed…leverage should decrease as one moves away from the natural person credit union level. The following capital expectations are proposed as a first step in the reorganization process:

Capital Thresholds
(proposed)

Natural Person CUs		
	'Well Capitalized'	7%
	Minimum Capital	2 – 4%
Corporate Credit Unions		
	Risk-Based (BASEL)	8%
	Minimum Capital	4%
US Central		
	Risk-Based (BASEL)	10%
	Minimum Capital	6%

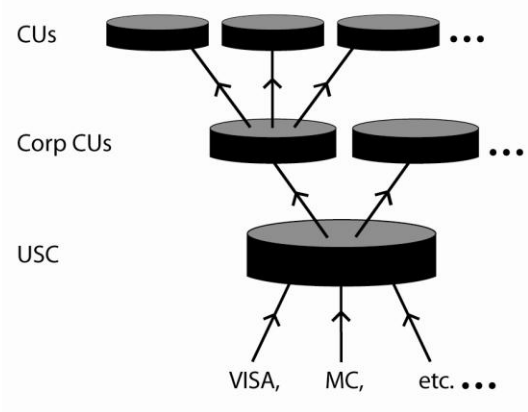
It might help to provide some numbers to illustrate how this could work. And, it should be understood that the only way to achieve higher capital ratios in the short run is to dramatically shrink balance sheets at the corporate credit union and U.S. Central level. In any case, the corporate credit unions had about $92 billion in assets on September 30, 2008. At the outside, capital (RUDE and PIC) equated to about 3% of assets. We envision that the corporate credit union tier could shrink to perhaps $46 billion and have sufficient funding to handle credit union settlement needs. If that was accomplished, capital ratios at the corporate tier would average 6%. This would be well above the proposed 4% minimum capital ratio. If U.S. Central's balance sheet shrunk to $10 billion for handling settlement activities, it should strive for a capital ratio of at least 6%.

- Protecting Settlement -

Since the settlement of remote access transactions is so critical to the credit union system, the aforementioned capital adequacy thresholds have in mind reducing corporate/USC balance sheets to sizes that are sufficient for handling daily settlement activities and housing small-denomination investments from credit unions that lack substantial surplus. It is our feeling that U.S. Central performs an extremely important role in settlement of remote access transactions. The credit union industry has the ability to project a single point of settlement contact for VISA, MasterCard and other major networks. While electronic posting records travel effortlessly to credit union host systems, the settlement accounts at U.S. Central and the corporate credit unions are unique in the financial services industry. If the credit union industry, for example, wanted to offer a "PayPal alternative" to eBay, Amazon and others, it could be done efficiently through

U.S. Central. Until/unless corporate credit unions can identify a more efficient solution, the U.S. Central charter and its settlement capabilities should be retained. By insisting on a higher capital ratio at U.S. Central, the risk exposure to the payments system would leave U.S. Central's balance sheet.

Remote Transaction Settlement



- Investment Risk -

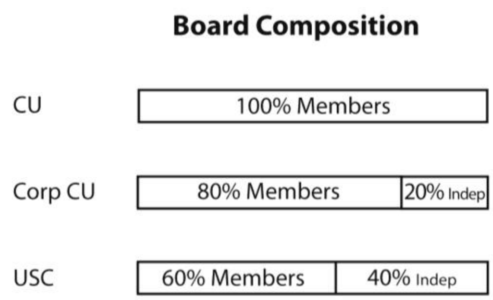
Investment risk, we think, needs to move closer to the natural person credit union balance sheet. Only they have the capital structures that are sufficient to support default, interest rate, cash flow and counter party risks embedded in term investment products. These exposures would not be eliminated at the corporate or USC tiers, but they would need to be reviewed in the context of risk limitations that would be appropriate for protecting the settlement activities. After three significant periods of financial stress, it is safe to say that mismatching cash flows represents an exposure for settlement balances. Corporate credit unions could/should become very active in providing/sourcing off-balance sheet investment advice, management and settlement. Fee income can be generated for these services and risk can be housed on the capital pedestals at natural person credit unions. Corporate credit unions may even consider it advisable to collaborate with some of these off-balance sheet activities…at U.S. Central. This should not be a problem as long as the balance sheet is not used to house excessive risk.

Investment Risk

CU	Low	Default Risk
	Some Int.	Rate Risk
	Some	Cash-Flow Risk
	Low	Counter-Party Risk
Corp CU	Minor	Default Risk
	Low Int.	Rate Risk
	Minor	Cash Flow Risk
	Low	Counter-Party Risk
USC	Minor	Default Risk
	Minor Int.	Rate Risk
	No	Cash Flow Risk
	Minor	Counter-Party Risk

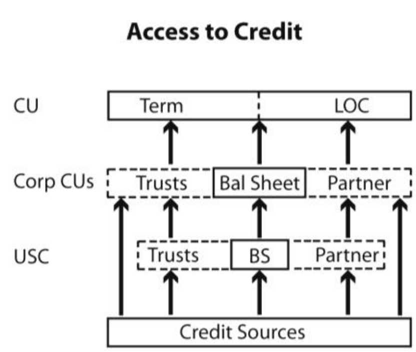
- Governance -

It is reasonable to think that corporate credit union and U.S. Central governance will be scrutinized under the circumstances. We think that prudent governance would include independent directors at the corporate level…and increasing levels of independence at U.S. Central. Our definition of an independent director is someone that has no connections to the members of the corporate credit union (or of U.S. Central Credit Union). By the way, excessive independence is a recipe for mis-alignment with member interests. There will, of course, be calls for continuing education and better transparency. We find it hard to believe that corporate credit unions could become more transparent…NCUA examiners have virtually lived with U.S. Central over the past several years. Notwithstanding, there may be opportunities for additional transparency. We doubt, however, that executive compensation has been a problem or that that exposing it to public audiences will have any meaningful risk management benefits.



- Access to Credit -

From time to time, credit unions need access to external credit. The Corporate Credit Union Network has established valuable contacts with virtually every conceivable source of external credit. Any reorganization of the corporate credit union system should pay close attention to the credit-sourcing capabilities. Our thought is that corporate credit unions could/should be involved in credit sourcing activities on and off-balance sheet. If credit is supplied on-balance sheet, we would recommend consideration of FHLB-style patronage capital contributions. For example, if a credit union established a $10 million settlement line of credit, it could be required to invest in patronage capital in the amount of, say, 2% of the line ($200,000). Patronage capital requirements for on-balance sheet lines of credit at U.S. Central could be higher…perhaps 4%. These amounts are competitive with similar arrangements at the Federal Home Loan Bank. Patronage capital contributions would alleviate a potential excess leverage problem on corporate balance sheets. Working off-balance sheet, corporate credit unions could establish collateral trusts, inter-lending arrangements and other facilities to help credit unions obtain cost-effective access to credit.



- Competition, Consolidation -

We are not in favor of arbitrary non-compete franchise territories that would be established by NCUA or any other government entity. Membership eligibility should not be confined by new field of membership limitations. Instead, <u>we favor the idea that corporate credit unions would be unable to provide service to credit unions that do not have PIC accounts</u>. With this approach, credit unions would be free to decide which corporate credit union it would use…and, would be limited to using those corporate credit unions where it made PIC contributions. <u>It is our view that PIC contributions should be established based on some relationship to credit union size</u> (not necessarily of linear proportions). With substantially reduced balance sheets, inefficiencies at some of the smaller corporates will become more apparent. Credit unions can handle inefficiency by refusing to capitalize an inefficient corporate…or supporting a merger with a more efficient corporate later on. Corporate credit union mergers should not be encouraged or discouraged. And, it should not be difficult to combine capital accounts in the surviving entity.

Sincerely,

Mike

Michael J. Mercer
President/CEO