April 3, 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

The Honorable Gigi Hyland
Board Member, National Credit Union Administration

Via email: regcomments@ncua.gov.

RE: Advance Notice of Proposed Rulemaking: Corporate Credit Unions

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

I speak from the voice of a small credit union CEO who has had a close working relationship with a corporate credit union that matches the small credit union needs in our general two state area in a very satisfactory manner. The corporate credit union system still fulfills an important role in the credit union industry and has provided credit unions with payment and clearing services, including access to wire transfer facilities and automated clearing house transactions. Corporate credit unions continue to provide investment services, enabling smaller credit unions to achieve economies of scale and access to greater market returns otherwise unavailable to them.

In my observations of the corporate credit unions it appears these corporates mirrored the philosophy of its memberships. In our case, the 2-state area of our corporate, First Carolina Corporate Credit Union is the “right fit” for us. The demographic area covered by FCCCU gives it the ability to correctly gauge the risk aversion of its members. As is well known, the people making up the membership of the credit unions of these two states are very conservative individuals.

The relative size of our corporate allows it to also look after the small credit union in a way that a large regional corporate would not be able to do. Given this, if the regional concept is the decision of the NCUA, there should be sufficient number of regional credit unions to provide a size that will allow it to meet the needs of the small credit unions. A few regional corporate credit unions, I feel, would be detrimental to the continued operations of the small credit unions in South and North Carolina. For the most part, choosing safety and soundness over high return, risky endeavors FCCCU mirrors our group. We do not want to go outside of the credit union system, and First Carolina Corporate specifically, for our correspondent services and products FCCCU does such a fine job in providing. The costs and services would not match up favorably to what we receive at this time.

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A review of the credit unions in North and South Carolina through the NCUA credit union data search shows there are 190 credit unions. 160 of these have less than $100 million in assets; 137 have less than $50 million in assets; 63 have assets less than $10 million. There are only 7 credit unions in the NCUA data for credit unions for North and South Carolina that have over $1 billion in assets.

I feel the fact that FCCCU had relatively little investment in private MBS is a direct indication FCCCU judged our aversion to risk to be very conservative.

It is imperative that the corporate credit union system continue to offer services of scale to small credit unions. These economies of scale is what all credit unions are looking to gain through partnerships to help us weather the storms and provide economic services to the members who seek small financial institutions for their personal and small business financial services. The corporate credit union system was already providing this help. They provide a level of expertise and market presence that would be unavailable to most of us, if required to rely solely on our own resources. It is extremely helpful, while I do not serve on the FCCCU board; I have a close working relationship with many of the board members. I am confident our voice is heard and carried forward to management.

If the NCUA's intention is to close down all credit unions under $100 million in assets, go with a 4 or 5 or even 6 regional corporate credit union system, you will accomplish this. The personal contact we have with all the staff at FCCCU provides us smaller credit unions with the sense of added staff at no expense. They are that concerned with our own success.

I beg, save the small credit union, particularly our small credit unions in North and South Carolina. Help FCCCU stay vibrant and viable for our benefit.

Sincerely,

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Reply to Specific Request:

1. The Role of Corporates in the Credit Union System

Health Facilities Federal Credit Union Reply:

Payment system

We feel the basis for concern is in proper liquidity management of the equation, not the payment systems. The payment systems offered by corporate credit unions is the vital part of the growth small credit unions have been able to gain in the area of share drafts and related services. There should be something to insulate the **liquidity risk** from payment systems but this can be accomplished within the current corporate model. The settlement process can be isolated from the investment process while still providing short-term liquidity for the natural person credit unions. This can be accomplished through the management and control of the investment side of the equation to insure the payment system provides the avenue to invest in short term or over-night funds for the benefits of the corporate members matched with the liquid investment of the corporate to provide the needed funds on demand. Longer term investment mix would be controlled to prevent the current liquidity problems through policy decisions of the member-elected board of directors and overseen by the proper regulatory agency.

In summary, we feel that the separation of the payment system and the liquidity system is neither feasible nor desirable. With proper capital, management, policy, board governance, and regulatory oversight, the current model will work.

Liquidity and liquidity management

Limiting the corporates ability to offer other products and services would be detrimental to credit union members of the corporates. Credit unions have come to trust and rely on the variety of liquidity, investment and correspondent services provided by their corporate and many credit unions see their corporate as an extension of their own staff. They rely on the corporates for this liquidity source. This is very true, again, of the small credit union which does not have the staff, expertise, or time to manage their liquidity in the detail needed to prudently manage the risk. The corporates, for the most part, and First Carolina Corporate in particular, have been a partner with their credit unions in being able to provide investment options. They have been our staff investment managers advising us at a fraction of the costs related to hiring such expertise.

Proper liquidity management at the corporate level should include analyzing historical and seasonal activity of their member credit unions over a specific time. This will give reasonable expectations for the liquidity needs of their member credit unions. This should include the proper projections of the member credit union needs for the short and long terms to adequately fund the needs. Then the management of short-term and long-term investments, along with proper capital levels and management policies and procedures, will allow the corporate to adequately meet the needs of its members. All with the mind-set of the appetite for risk of the local credit union.

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There should be additional avenues for credit unions, possibly outside of the corporate model, for those credit unions which need and can absorb differing investments it might not be prudent for the corporate to handle. These might be within the government arena with government securities, FHLB investments or in the private arena with insurance company products, for example—all with limited corporate exposure.

Field of Membership Issues

We are inclined to seek regional Field of Memberships. This is to allow the corporate to assess the aversion to risk of the member credit unions. As we think about regional membership, it is hard for us to present an acceptable model that would allow a corporate to grow past a certain demographic area but stay regional in concept. An example might be for the expansion of our North/South Carolina footprint to include Georgia, Florida, Tennessee, or Virginia while allowing the corporates traditionally serving those areas having access to the Carolinas.

An acceptable alternative must include the corporate requiring a uniform capital investment by its credit union members into the corporate. This would allow the corporate to gain capital as it expands and has a “pay to play” function. This would prevent some corporates offering services to credit unions without capital investment. If a credit union wants to deal with more than one corporate, they would have to have a capital investment in the corporates it chooses to do business with.

Expanded Investment Authority

The expanded investment authority already present in Part 704 probably led to the problem we are facing today. Although almost all financial institutions adversely affected by the markets during this recent economic situation thought they were investing in low risk, AAA investments, the relying on another entity to set the risk or do the due diligence on their investments are also responsible for the problem.
It is our opinion most credit unions, particularly in our area, would be adverse to the expanded authority that would put our capital investment, in the corporate, at risk. We are losing our capital investments now because of other corporates and US Central taking what we feel were unsafe risks. This is proving true as the system folds under the number of negative NEV corporates.

We must have a system where the corporate credit unions must stand on its own. There has to be sufficient capital, investment, management, regulatory mix for sufficiently handling the risk of expanded investment authority or there must be a separate insurance fund to support the corporate system

As a small credit union, our opinion is that if a credit union was in need of those higher risk investments, let the credit union itself go out in the market and buy the investment without putting our capital investment in the corporate at risk.

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Structure; two-tiered system

The two-tier corporate system has served the credit union system well. If properly managed and reviewed, it still can provide a variety of products in economy of scales not afforded to credit union or even smaller groups of credit unions.
The services provided to us by the two tier system has allowed us to be able to offer services we would not have been able to afford or that we would have had to go out of the credit union system to obtain at increased costs.
There should not be any risks assumed due to individual investments by the upper-tier wholesale credit union. These risks should be passed down to the corporates requesting the risky investment and ultimately to the individual credit unions seeking the higher risk investment. They need to show sufficient controls and liquidity to support that risk.
The two-tier corporate system was set up to provide credit unions and corporates centralized resources to take advantage of economies of scale. This still remains an advantage of the current corporate system. As a small credit union struggling to have a positive income, I do feel there needs to be control taken to prevent the actions of some from jeopardizing the financial health of all. I feel the NCUA oversight in the corporates with negative NEV let us down. The NCUA, in those corporates, on a daily basis should have had more insight and a quicker reaction to prevent the magnitude of this size problem.

2. Corporate Capital

Core capital

We do not have the expertise to decide the proper level of capital needed to insure safe operation.

We do feel that any NPCU dealing with a corporate credit union should have a paid in capital investment in that corporate. If a credit union decides to be members of multiple corporates, they would need to have paid in capital into each of the corporate systems. We also feel this accumulated capital in each corporate credit union be sufficient to sustain the risk of investment and operation during any cyclical decline of the economy it serves.

We would rely on educated experts to help establish the safe and proper level to prevent the degradation of the credit union system that would protect credit union capital and retained earnings at risk.

A minimum combination of paid in capital and retained earnings should be sufficient to handle the expected losses of investments. This would be set at a formula that took into consideration the operations of the corporate, the review of their investment portfolio, and the results of an outside, meticulous audit. The amount of capital carried above this minimum should be at the discretion of the corporate’s membership as presented through the corporate board of directors or annual meeting within their bylaws.

The review of adequate capital on each level of corporate credit unions should be ongoing with adjustments in the required capital as needed to acknowledge the risks of their actions.

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Membership capital

If membership capital is made available within the corporate system, it must conform to Tier one capital, on par with the paid in capital. This would insure all member/owner credit union has the same risk by asset size as any other.

Risk-based capital and contributed capital requirements

If corporates follow Basel capital standards then they would be subject to a risk-based capital standard as well as a minimum Tier One capital level. We believe these risk-based capital standards would be appropriate.

To properly capitalize risks pertaining to funds management, we believe, as stated several times in this document, corporate deposit services should be limited to members that contribute capital. We also believe the calculation for determining a credit union's required capital contribution should be standardized across all corporates. What I saw over the past couple of years was an unhealthy competition where some corporates aggressively sought NPCUs outside their normal core, enticing them with incentives not available to their core membership. This providing service with no paid in responsibility has caused this current problem to be more of an unfair burden on the credit unions with paid-in capital.

3. Permissible Investments

If the investment risk is taken by the ultimate requester of the investment, the NPCU, the ability to make sure an investment would rest on the capital and strength of that credit union, its policy, and the aversion to risk its board of directors choose to accept. This would be a pass through liability of the ultimate benefactor of the increase interest/investment income. Those choosing to take the higher risk/reward investment should not but the burden of the risk on those of us who do not want that risk. In other words, we must all take the responsibility of our actions.

4. Credit Risk Management

We feel the re-organization of the risk rating system and review will be a major undertaking by the securities and financial institution regulator system. The NCUA should have a seat at that table to help formulate the system to protect from this situation from ever occurring in the future.

There needs to be some responsibility to adequately investigate investment vehicles for ratings. The manner and due diligence in the setting of the value or rating of an investment should be defined rigorously and monitored stringently. There needs to be a liability system where the rating issuer must back up their rating.

Beyond this there would need to be well reasoned limits. Also, the corporates making the more risky investments must demonstrate they have adequate expertise on staff or contracted to adequately and concisely determine the correct risk of the investment.

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5. Asset Liability Management

A set of asset liability modeling tools need to be used or developed to prevent the re-occurrence of the recent problems.

The modeling must be overseen, tested, and verified on a constant, ongoing basis.

This could be in the form of, or combination of: net income simulation, spread modeling, and other risk measurement tools.

6. Corporate Governance

Retail corporate level: The current process of the membership electing non-compensated representatives of the members is appropriate for the credit union system. We would suggest that perhaps ALCO committees have representation from staff, board, and 1-2 non-directors from within the credit union system who have expertise with ALM functions. (CFOs or Investment Officers)

Wholesale corporate level: We believe that if there is a wholesale level organization it should have directors from both corporates and natural person credit unions. The NPCU representatives would essentially serve as “outside directors” and could be elected from credit unions that have capital in the corporate network. I would strongly suggest some small credit union representations be assured at each level of governance.

Compensation of directors seems to be related to the use of outside directors as it might be difficult to get someone from outside the credit union system to serve on a board without compensation. If the so-called “outside directors” come from within the credit union system, compensation may not be appropriate.

We feel there should be a method of board rotation that allows board members to gain the knowledge to work affectively, use that knowledge to help govern the corporate for a period and then rotate off. This would keep the board fresh and prevent some individual or groups of individuals from holding the corporate hostage for their own benefit.

All corporates should set minimum qualifications for directors based on the overall complexity of its operation and investment authorities. However, some board positions should be available for the smaller credit union participation.