CREDIT UNION of NEW JERSEY

Credit Union of New Jersey

Response to NCUA Advance Notice of Proposed Rulemaking

April 6, 2009

Payment Systems

CUNJ relies on its corporate as its Primary Financial Institution (PFI). Payment system services are an integral part of our daily operations as we are a full service credit union settling ATM/Debit, Share Drafts, Bill Payment, Sponsor Payrolls, and Wire Transfers plus more through our corporate. We prefer to deal with our corporate exclusively for our correspondent services.

To address the risks and costs associated with payment services CUNJ believes it would be prudent to consolidate payment systems into a national CUSO with the ability to use "excess capacity" to serve non-credit union entities. Some level of risk mitigation is also prudent to insulate the payment system from potential disruption of payments. Reserves against settlement and assignor capital would be appropriate.

Liquidity and Liquidity Management

Corporates are the Primary Financial Institutions (PFI) for most credit unions. Liquidity and Liquidity Management are core services but so are other services such as settlement, payment, correspondent services and investment and lending services. Restricting other services is not an attractive option as CUNJ finds value in the broad services it receives from its corporate.

Field of Membership Issues

To succeed corporates must cooperate for the benefit of their members. National FOM's have resulted in better pricing for NPCU members but at the same time has weakened the corporate network due to replicated operations, lower margins and lower capital. Cooperation in redundant systems and services would increase efficiencies, free up capital in the system for innovation and focus our industry on competing with banks and others. A regional FOM would make the most sense with a membership capital requirement. The ability to select a "Corporate of Choice" would also make sense as long as the NPCU maintained capital with whichever corporate it chooses.

Expanded Investment Authority

So long as a corporate meets the stated regulatory criteria they should have expanded investment authorities. Without these authorities corporates would be very limited in their ability to offer a wider variety of products at competitive prices and would also have fewer tools to manage their balance sheet risk effectively.

Reviewing and revising the criteria to qualify for part one expanded authority as it relates to capital is preferred over eliminating authorities.

Structured Two-tiered System

The two-tier system should be collapsed into one to eliminate one layer of required capital in the system. The remaining retail corporates should be consolidated into 6-8 corporates. Efficiency would be greatly improved over time as the multitude of redundant systems would be combined, possibly into several central CUSO's. There should be multiple corporates as concentration risk would be too great for one corporate. This would provide the best chance for the network to build and retain capital.

Corporate Capital

There should be a new core capital requirement (undivided earnings and perpetual paid-in-capital) of 4% within three years. This would allow corporates sufficient time to build retained earnings and solicit members for Tier 1 paid-in-capital. A target of 6% core capital should be the long term goal. The current calculation of the capital ratio using the 12-month daily average net assets (DANA) is appropriate to smooth out seasonality. Membership Capital Shares (MCS) should be retained as an option.

Risk-based capital should be considered. Just like NPCU's, corporates have different levels of risk on their balance sheets and should be required to maintain capital levels commensurate with risk.

Requiring an NPCU to contribute capital to its corporate as a prerequisite to obtaining services is appropriate and should be based on assets to effectively transfer NPCU capital "up" to the corporate network that it owns. An appropriate level would need to be determined as well as reviewing caps.

Permissible Investments

Corporates have a distinctly different purpose than natural person credit unions and should be permitted to invest in a broader range of investments. The balance sheet strategies, especially in terms of liquidity management and hedging are different and require expanded authorities over that of NPCU's. A corporate must demonstrate the expertise to receive the expanded authorities.

Credit Risk Management

Prior to the current financial crisis corporates and other financial institutions relied heavily on credit ratings. “AAA” was in effect a seal of approval. Corporates must put less weight on the credit ratings in light of the expected losses on so called AAA rated investments. Although out of the purview of NCUA the rating agencies need to rethink their approach and minimize conflicts of interest. Corporates should be required to obtain multiple ratings, conduct external reviews for new security types, limit cash flows and duration, establish both obligor and sector limits and have portfolios reviewed for credit risk by an external third-party.

Asset Liability Management

Reinstate net interest income modeling and stress testing. Model and test credit spread increases. Require external reviews of processes.

Corporate Governance

Corporates are cooperatives governed by their owners. The governance should be by its owners and not outside directors. To apply that rationale you would then need to look at some NPCU’s which are also large and complex, and in some cases larger and more complex than some corporates. Requiring minimum qualifications is reasonable, which most corporates already do. Requiring an ongoing training program and demonstrated proficiency through testing is appropriate. Any decision on outside directors, term limits and compensation should rest with the ownership. Disclosure requirements of executive compensation information should be the same for all credit unions.

Final Comments

We believe the corporate network is vital to our success. Credit Unions are a unique and distinct sector of the financial services landscape and no one knows and understands NPCU’s financials needs like corporates. Limiting the services offered by corporates would drive credit unions to the very industry that is battling us at every turn. Keeping credit union business in the credit union industry is paramount. The financial crisis has exposed certain weaknesses in our corporate network like it has in other industries. Significant change to the systems and processes that exposed corporates to market risk undoubtedly needs to happen. However, we urge NCUA to carefully consider actions that would radically change components of the corporate network that were not at the root of the issue.