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April 6, 2009

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

RE: **Advance Notice of Proposed Rulemaking for Part 704**

Dear Ms. Rupp:

On behalf of the National Association of Federal Credit Unions (NAFCU), the only trade association that exclusively represents the interests of our nation's federal credit unions (FCUs), I would like to respond to the National Credit Union Administration's (NCUA) Advance Notice of Proposed Rulemaking (ANPR) on Changes to the Corporate Credit Union System.

As NCUA moves to continue to stabilize the corporate system (corporates), and potentially change the business model of how the corporate system operates, NAFCU urges the agency to take into consideration the appetite amongst natural person members to recapitalize the system. In NAFCU's approach below, we have attempted to suggest a corporate system that achieves the goals of serving natural person credit unions, without changing the system so much so as to require a huge outlay of additional capital.

After NCUA released the ANPR, the NAFCU Board of Directors appointed a task force to examine the various issues addressed in the ANPR and construct principles on which NAFCU would base its comments. The principles, which were refined by the NAFCU Board of Directors are set out below.

- *Corporate credit unions should continue to serve the liquidity and operational/payment systems needs of natural person credit unions.*

    1. Any solvent corporate credit union should be permitted to survive; voluntary mergers will achieve economies of scale.

2. Corporates investment authority should be carefully regulated: for investment authority going forward, knowledge is key and independent risk analysis must be performed.

- *Corporate credit unions should operate under a risk-based capital system.*

1. Maintaining membership capital should not be mandatory.

2. Voluntary membership capital should be structured with a maximum cap and assessments based on usage.

- *Corporate credit unions should operate under corporate governance standards created and policed within the industry.*

1. Board members should consist of only qualified natural person credit union directors and staff.

2. There should be term limit requirements such as 3 years, 3 terms.

3. There should be no trade association or league staff members allowed on corporate boards.

4. There should be an independent supervisory committee that can hire outside expertise as needed.

5. There should be an investment oversight committee; it should be permissible for outsiders to be members of the committee to access requisite expertise.

Regarding each of the principles, NAFCU provides the following specific comments:

***Corporate credit unions should continue to serve the liquidity and operational/payment systems needs of natural person credit unions.***

Whether natural person credit unions still need a corporate system was a preliminary question that was addressed by the Task Force. NAFCU believes that natural person credit unions can still benefit from having a corporate system. A payment system and investment provider that understands the unique nature of credit unions is beneficial to our membership. While some larger credit unions may not use the corporate system, most credit unions find one or more of the services of the corporates to be superior to any alternative in the market, or at least appreciate that corporates provide a viable alternative.

In terms of the structure of the corporate system, NAFCU believes that any corporate credit union with sound capital in place should be permitted to survive. NAFCU's Task Force considered a number of alternatives to achieve economies of scale in the corporate system. NAFCU has concluded that in order to weather the current economic downturn, and recapitalize the corporate system, existing healthy corporates should continue to operate. Natural market forces will provide for any consolidations in the corporate credit union structure. Further, measures should be put in place to prevent future credit losses in the corporates from being absorbed by all natural person credit unions, regardless of their level of usage of the corporate system.

NCUA asked a number of specific questions in the ANPR relative to structure. NAFCU does not believe that separating payments and investment functions of a corporate is advisable. Creating a separate corporate or just a firewall between functions creates too much risk concentration on the one hand, and an unnecessary legal distinction on the other hand, without any real benefit.

*Corporates investment authority should be carefully regulated: for investment authority going forward, knowledge is key and independent risk analysis must be performed.*

NAFCU believes that current corporate investment authorities should be maintained, but that NCUA should address concentration risk. NAFCU members are concerned that boards of certain corporates did not do appropriate due diligence when investing in certain mortgage backed securities - even though they were AAA rated. We believe that to avoid a similar situation from occurring in the future, regardless of the action taken on the part of corporate boards, NCUA should institute measures to prevent too much concentration risk in any area. Stronger corporate governance in the area of due diligence is also necessary to prevent a similar credit crisis from happening again.

***Corporate credit unions should operate under a risk-based capital system.***

Under 12 C.F.R. Part 704, corporate credit unions are currently required to maintain a minimum capital ratio of 4 percent, unless the Director of NCUA's Office of Corporate Credit Unions (OCCU) determines that, based on certain factors, a different minimum capital ratio is warranted. *See* 12 C.F.R. § 704.3. When a corporate credit union's capital ratio falls before the regulatory minimum, it must notify the OCCU and, under certain circumstances, OCCU may require a restoration plan and take other action.

NAFCU believes the current corporate credit union capital regulations are inadequate and should be revised. Given that the core purpose of corporates is to provide liquidity for the members, to meet such needs, corporates must have the ability to take on reasonable risk. However, regulation of corporate capital must be sophisticated enough to ensure current and future complex investments and financial assets are adequately and appropriately addressed. Changing market conditions must also be addressed.

Indeed, we strongly urge the NCUA to institute a risk-based capital regulatory regime for corporate credit unions. We support a risk-based regulatory system consistent with Basel I and Basel II Accords where assets with higher credit risk would require more capital in reserve than low-risk assets, and capital requirements are linked to classes of assets. A minimum risk based capital ratio, calculated as capital divided by risk-weighted assets, should be required. Assets with minimal or no risk, such as cash and government-backed securities should be assigned the lowest weight for risk. Conversely, the agency should assign the highest weight to mortgage backed securities and asset backed securities that are not government backed.

We urge the agency to be mindful of the fact that any risk-based system must take into full consideration the restrictions on capital that the credit union industry, including corporates, face. One of the most significant considerations should be that, unlike institutions currently under risk-based capital regulations, corporates are not authorized to tap into capital from sources other than their membership. While this constraint is consistent with the cooperative principles under which the credit union industry operates, it is also an obstacle that must not be overlooked in designing a risk-based capital regulatory structure.

We also believe that NCUA should supplement any risk based capital regime with a required minimum "leverage capital" that corporates must maintain and which consists of core capital. Core capital should consist of only retained earnings and paid-in capital. We believe that the minimum leverage capital should be determined based on the corporate's financial strength.

NAFCU notes that NCUA currently has the authority to institute a risk-based capital regime for corporates. In fact, we believe that NCUA's oversight function of the system-wide safety and soundness calls for the agency to re-assess, rethink and modernize its regulations regarding corporate capital. Despite NCUA's authority and

what we consider the appropriate timing and opportunity to institute a risk-based capital system for corporates, we urge NCUA to devise a plan for corporates to follow during a transition period leading up to an effective date for a risk-based capital system.

*Maintaining membership capital should not be mandatory.*

In regard to membership capital, the NCUA is considering changes to many aspects of the regulations. The ANPR states that the agency is examining the adjustment feature of membership capital, including whether to tie adjusted balance requirements only to assets and requiring that any attempted reduction based on downward adjustment automatically results in the account being placed on notice (i.e., three year remaining maturity). NCUA is also looking at whether to require that any withdrawal of membership capital be conditioned on the corporate's ability to meet all applicable capital requirements following withdrawal.

NCUA does not insure membership capital. And, membership capital follows retained and paid-in capital in the line for absorbing losses. Natural person credit union membership capital has been used to absorb recent losses in corporate credit unions, thus compounding the cost on the member credit unions to stabilize the corporate credit union system.

Under a risk-based capital system, natural person credit unions should not be required to contribute membership capital. Rather, as discussed below, the amount of membership capital that natural person credit unions contribute should depend on usage of their corporate credit union's services. A corporate credit union could require membership capital to operate if it so chooses.

*Voluntary membership capital should be structured with a maximum cap and assessment based on usage.*

Currently, NCUA does not have a maximum cap on membership capital that natural person credit unions contribute. Natural person credit unions' contribution, further, is not linked to usage.

Should a corporate board require membership capital from its users, NAFCU supports a regime which would provide an individual maximum amount that a natural person credit union could contribute. A cap, we believe, in conjunction with stricter regulatory oversight of risk, will serve to control risk exposure of individual credit unions, and ultimately, the industry as a whole.

In addition, membership capital contribution should be based on usage. That is, the amount of membership capital that a natural person contributes should be directly correlated to its usage of the corporate's services. Thus, those credit unions that use the corporate more would contribute more membership capital and ultimately take on the greatest risk of loss of membership capital.

***Corporate credit unions should operate under corporate governance standards created and policed within the industry.***

The NCUA also seeks comment on a number of matters related to the governance of corporate credit unions. Specifically, the agency seeks comment on: whether board members should be required to possess certain experience and independence; the merits of term limits; compensation for directors; greater transparency in executive compensation; and whether a new category of "outside directors" should be created.

These changes would be a dramatic shift from the current regulations, under which there are relatively few requirements or restrictions regarding corporate credit union board members. Currently, corporate credit union directors must: approve a comprehensive strategic plan; generally ensure staff is knowledgeable and well trained; ensure GAAP is followed whenever necessary and that financial statements are accurate; ensure systems are audited routinely; evaluate financial performance and oversee planning to address major risk areas. *See* 12 C.F.R. §704.4. Currently, the regulations do not require any special skill, knowledge or training of corporate credit union board members.

Beyond the duties listed above, there is relatively little law regarding the NCUA's oversight of corporate credit union directors. Directors are held to the duties of standard and care which applies to virtually all corporate directors. NCUA Letter No. 2005-02. The NCUA did provide guidance on how credit unions might apply principles of the *Sarbanes-Oxley* Act to their directors. NCUA Letter No. 03-FCU-07. However, the guidance was discretionary as the law only applies to publicly traded companies.

*Board Members Should Consist of Only Qualified Natural Person Credit Union Staff and Directors*

While NAFCU understands the merits in having so-called "outside directors" we believe that those who work in the credit union industry and use corporate credit union services will ultimately prove to be the best stewards of the corporate credit union system. The paid-in capital and membership capital that natural person credit unions have invested in the corporate credit union system ensure that these stakeholders will be motivated to protect their investment and properly oversee the corporate credit unions. While "outside" directors may provide some degree of independence, NAFCU believes that qualified natural person credit union staff and directors serving on the corporate boards of directors are equally capable of acting as independent agents. In addition, board members within the industry will better understand credit union operations and have a vested interest in protecting their investment and their industry.

To be clear, those individuals who do serve as directors should be qualified and have considerable knowledge and skill in fields such as – but not limited to – investing, accounting and the law.

*Term Limits Should be Imposed on Board Members*

NAFCU believes that corporates should impose term limits on board members. Term limits will ensure that corporate credit unions are continually subject to oversight from new board members who will question old assumptions and raise new concerns. While we believe term limits will be helpful to the overall governance of the corporate credit union system, we would like to stress that the corporate must balance two competing goals; injecting new blood into the boardroom and ensuring the board has sufficient institutional knowledge to be productive. With that in mind, NAFCU supports term limits along the lines of three terms of three years each. Additionally, in order to ensure a smooth transition when new board members are elected, NAFCU recommends staggering the terms for the board members so that only one-quarter to one-third of the board are elected at any one time.

*No Trade Association or League Staff Members Should Serve on the Board*

NAFCU supports prohibiting trade association or league staff members from serving on the boards of corporate credit unions. As the agency is well aware, trade associations and the leagues receive dues from some of the corporate credit unions. In some cases, the payments involve a significant amount of money. In order to protect against real conflicts of interest as well as the appearance of conflicts of interest, representatives from associations should not be allowed to sit on the board of directors. This is, NAFCU believes, a common sense approach to deal with the issue of conflicts of interest, whether they are real or perceived.

*The Board should have an Independent Supervisory Committee*

NAFCU believes it is important that the corporate board have an independent supervisory committee with the authority and means to hire outside expertise as needed. Even if certain knowledge skill and experience requirements are required for corporate board members, more should be done to ensure adequate and complete oversight. Nearly every board member will have a demanding full time job that competes with time spent serving on the corporate board. Further, given the size and diversity of the corporate credit unions it is unreasonable to assume that the board has the time necessary to completely and thoroughly examine all of the company's financial dealings.

To this end, it is imperative to arm the board with the tools necessary to ensure they have a complete and accurate understanding of the corporate credit union's activities. In most cases this will likely not be an issue. However, should the supervisory committee feel more information is needed or, in extreme cases, that it is not receiving accurate information from the staff, the committee should have authority to hire outside parties as necessary to review financial or other records.

*Each Board Should Have an Investment Oversight Committee*

The crux of the problem for the corporate credit union system lies in investments that have since drastically depreciated in value. In order to augment the powers of the directors, each board should include an investment oversight committee which could – if it so chose – include "outside" members with expertise in the corporates. While NAFCU believes there should be no requirement of "outside" board members, we believe this is a reasonable compromise. The proposal would provide the board outside expertise when necessary without compromising the cooperative spirit of credit unions, which we think is best served by having only natural person credit union members serve as corporate credit union directors.

***Additional Issues***

As NCUA continues to stabilize corporate credit unions, the actions taken on the part of the agency will have longstanding effects on credit unions that use corporate credit unions and those that do not. NAFCU again urges the agency to establish a corporate credit union system where only users of the system bear the risk of loss. NAFCU believes that the changes above, taken as a whole, will act as a means to reform the system for the better, but if implemented piecemeal, additional protections may be necessary. NAFCU stands ready to provide the agency with more feedback regarding the corporate system and looks forward to seeing changes in the future.

Finally, NAFCU supports the ability of the Central Liquidity Facility to lend directly to corporate credit unions if creditworthiness restrictions are in place. Under current law, only natural person credit unions may borrow from the CLF. Permitting corporate credit unions to do the same, will allow more flexibility in corporates' ability to manage liquidity.

NAFCU appreciates this opportunity to share its comments on this advance notice of proposed rulemaking. Should you have any questions or require additional information please call me or Carrie Hunt, NAFCU's Senior Counsel/Director of Regulatory Affairs at (703) 842-2234.

Sincerely,

Fred R. Becker
President/CEO

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