April 6, 2009

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

Re: ANPR – 12 CFR Part 704 for Corporate Credit Unions

Dear Ms. Rupp:

Thank you for the opportunity to respond to questions and concepts associated with change in the Corporate Credit Union Network. As with the global financial system, the United States financial system, and the credit union industry, change driven by economic forces is imminent. We at FirstCorp advocate the existence of entities with the single goal of adding value to natural person credit unions. FirstCorp's comments are driven by that fundamental mission.

Payment Systems

Payments systems at FirstCorp include electronic check processing, official check and money order issuance and clearing, automated settlement of numerous clearing products such as ACH, electronic investment and loan advancement, international and domestic funds transfer, and an average of over $300 million in cash delivered to credit unions each month. Each of these of payment system products involves the movement of funds requiring a settlement point for each type of transaction.

Of extreme importance to credit unions and consumers, is our current simplified settlement process where dollars settle into an account paying a market rate of return. It would be cost prohibitive and time intensive for a credit union to replace this aggregated and efficient approach to payment system products and the related settlement.

Staff time related to balancing multiple accounts related to dollar settlement and data posting would be coupled with fees associated with maintaining processes requiring multiple settlement end-points for dollars and data. Separating payment systems from other services would increase costs and decrease efficiencies. Payment systems issues are not the cause of our current dismal economic state. Credit risk being underestimated and this risk being highly concentrated in one organization, are the major causes of our current economic woes.

Liquidity

As the risk associated with various types of asset backed securities became evident, the secondary market for these instruments ceased to exist. The normal practice of US Central and other corporate credit unions of selling these instruments for liquidity needs could not be exercised. Liquidating investments in a nonexistent secondary market has, and will have, devastating impacts to balance sheets.

Suddenly, the normal and routine practice of liquidating products during the summer draw-down cycle that was typical for many credit unions was no longer an option. Unfortunately, a liquidity crisis then materialized as a byproduct of credit risk being underestimated and being too highly concentrated in one institution.

Clearly, it would be prudent for all credit unions to have multiple sources of liquidity as many currently do. Corporate credit unions should be Included on a multiple source list for liquidity. However, it would not be prudent to manage to a worst-case scenario liquidity cycle, as this would be too costly. Holding all deposits in cash accounts would provide for a very large investment opportunity cost in most yield curve environments. The resulting high opportunity cost from keeping assets short would render the corporate uncompetitive in other operational areas.

Should a corporate be rendered uncompetitive, and therefore unviable, so be it. Yet the viability decision should be determined by member owner credit unions and not an onerous provision in a regulation. Should a corporate decide to fill a niche of being a liquidity provider as driven by member owners, they would need to manage accordingly. Should a corporate decide to focus on other functional areas as driven by member owner credit unions, they would manage accordingly.

Micromanagement is not needed in this area. To name a few sources in addition to the fundamental source of member deposits, liquidity can be accessed from the Federal Home Loan Bank for qualifying credit unions, the Federal Reserve Bank for qualifying credit unions, and from corporate credit unions choosing to fill the liquidity niche. A corporate credit union's focus or lack of focus on liquidity should be dictated by its member owners.

Field of Membership

Alternatives are good for credit unions. A credit union should have the ability to choose regarding service providers within the credit union industry and outside of the credit union industry. Corporates are not the only entities suffering losses as a result of current economic conditions which, means that the number of service providers available is contracting. As long as a credit union is willing to invest in Tier 1 capital (as defined by GAAP) of a corporate credit union, a corporate credit union should be an option for credit unions from which to access services.

Expanded Investment Authority

Expanded Investment Authority did not cause our current problem. Credit risk being underestimated and this risk being highly concentrated in one any organization drove us to our current state of capital erosion. Specifically, the securitization of very poorly underwritten assets and a flawed rating process is the reason the world is experiencing high levels of credit loss. The "Authorities" are adequate as written.

Structure: Two-tiered System
Credit risk being underestimated and this risk being highly concentrated in one organization, are the main factors contributing to losses and potential losses at US Central, corporate credit unions, and natural person credit unions. These factors must be addressed via revised regulation and the examination process.

A phased in approach would address the question of tiers within the corporate network. Most likely, responses to this ANRP will call for a variety of actions ranging from comments such as, “change nothing – we love our corporate,” to “abolish the network, we hate corporates and they are responsible for all of the economic carnage around the world.”

Immediate action needed:

Require US Central to comply with a risk-based and Tier 1 capital requirement as noted in the “Capital” section of this document. This action provides for controlling and monitoring credit risk.

Mid-term action needed:

When US Central is given back to the credit union industry, provide for the majority of board members to be leaders of natural person credit unions. This action provides for natural person credit union leadership to influence the structure of the corporate network.

Longer-term action needed:

After any structural changes to the corporate network are determined by natural person credit union leaders, implementation of change could begin.

Simply eliminating the corporate network would place many medium and smaller sized credit unions in harms way. Even though it is true that all products and services provided by a corporate credit can be replaced, I argue that costs would increase, and efficiencies would decrease as a result. Many credit unions would cease to exist without a corporate network. Maybe some larger organizations want this to be the case.

Also lost would be market influences provided by corporate credit unions. The mere market presence of a corporate credit union provides downward pricing pressures on replacement products and services. More choices in the market place with healthy competition provide not only price control, but drives necessary innovation. For credit unions of any size to be viewed as a primary financial institution for consumers, they must have the ability to offer the latest and greatest consumer financial services and products at a competitive price. In other words, corporates assist many credit unions in maintaining viability.

The “phase in” approach to changing the corporate network described above enables credit unions to amend the corporate network structure. This is a preferred strategy to structural change driven by provisions within a regulation.

Capital
Credit risk being underestimated is a major factor attributing to global, national, and credit union capital erosion. Credit risk needs to be addressed via the statutory process. A risk-based capital

provision within the revised corporate rule would address credit risk. Heavily weighting investment assets deemed to carry high levels of risk would provide for regulators to contain and monitor credit risk. Trigger points should be in place requiring the immediate sale of instruments to bring a breached risk-weighted minimum capital ratio back within regulatory guidelines.

The weighting of an instrument should be monitored and adjusted after purchase as economic conditions improve or deteriorate. A bond's weighting should be adjusted after purchase based on ratings changes published by rating agencies. An upgrade or downgrade by two "qualified" rating agencies would dictate a change in the weighting of a given bond. If the adjustment process brought a risk-weighted capital ratio below the minimum regulatory level, immediate action would be required as indicated in the previous paragraph.

Current NEV Ratio requirements contained within NCUA Rules and Regulations Part 704 for Corporate Credit Unions section 704.8 adequately addresses asset liability miss-match risk. Although I am not sure if any amount of regulation could have protected against the current economic woes being experienced internationally, nationally, within the corporate network and natural person credit unions. A risk weighted capital ratio requirement combined with a Tier 1 (as defined by GAAP) capital requirement would be an improvement to the corporate rule.

Specifically, a minimum Tier 1 capital ratio of 4%, combined with a minimum risk-weighted capital ratio of 8% would provide for more safety and soundness – a desired goal of regulatory reform. My suggestion is for Tier 1 capital to be a condition of membership and available to credit unions and credit union entities. Should a corporate be unable to raise capital or manage its balance sheet to meet or exceed regulatory minimums, they would cease to exist. In that instance credit unions will have made a statement sending the loud and clear message that the corporate in question is not wanted. Credit unions would have made the decision as should be the case.

Permissible Investments

As a "Base Case" corporate defined in NCUA Rules and Regulations Part 704 for Corporate Credit Unions, FirstCorp did not invest in certain high-risk products such as CDOs and NIMs possessing investment characteristics requiring Expanded Investment Authorities. As such, we are not exposed to the risks associated with CDOs and NIMS. The permissible investments as limited for "Base Case" corporates combined with a risk-weighted capital ratio requirement and reasonable concentration limits would serve the industry well. This scenario would address credit risk being underestimated and too much concentration of this risk being in any single entity – the main factors driving the conservatorship of our two largest corporates resulting in natural person credit union capital erosion.

An instrument that would add value to investment portfolios while providing a high degree of safety and soundness is a Covered Bond. Covered Bonds are full recourse debt obligations of the issuing financial institution, secured by a pool of performing eligible assets that remain on the balance sheet of the issuer. Clearly a certain amount of risk is present with Covered Bonds as with any asset backed security. However, two key differences reduce the risks associated with a Covered Bond.

First, the pool of performing eligible assets securing the bond is separated from the other assets of the issuer in the event of insolvency. Second, the full recourse covenant attached to Covered

Bonds ensures sound underwriting and servicing practices unlike many securitization bond issues causing losses around the world today.

Credit Risk Management

Credit risk being underestimated is the single most important factor that needs to be addressed via the rule making process. This underestimated risk is the reason huge losses are being realized around the world, in our nation, and in the credit union industry. Risk-based capital ratio requirements along with trained state and federal examiners doing their job would mitigate the possibility of a repeat of the massive losses being realized today. The weighting should be reviewed and adjusted periodically reflecting changes in the economy and other factors driving the performance of a bond. In any given period when a risk-based minimum capital ratio becomes out of compliance, adjustments to the investment portfolio must be made immediately providing for compliance.

This simple mandate provides for an immediate correction of an “out-of-compliance” situation. Even though losses would likely be incurred, they are realized quickly. Credit managers would have to manage with a “risk-averse” mentality as opposed to a “make as much as possible and focus on gaining market share” mentality.

Asset Liability Management

Risk based capital requirements cover credit risk, and NEV ratio requirements cover asset liability miss-match risk. Net Interest Income analysis was very interesting and useful for looking at earnings and the effect of changing interest rates. However, this was removed from the corporate rule mainly due to the fact that the extremely tight NEV erosion limits that NCUA introduced effectively limited the amount of balance sheet duration mismatch that a corporate credit union could put on its balance sheet.

Natural person credit unions have had, and will always have, much more duration mismatch between assets and liabilities than corporate credit unions due to their business model. This type of modeling for natural person credit unions is more than appropriate due to this type of exposure. Net interest income simulations would have provided little benefit in identifying or limiting the problems currently facing corporate credit unions as well as many other financial institutions. This is evident in the fact the majority of security holdings of the two corporate credit unions that have been put into conservatorship continue to receive scheduled principal and interest payments, yet significant credit losses are expected in the future. Net interest income simulations would not have captured any of this risk.

Modeling and testing credit spread increases could have potentially identified a broad range of potential exposure. However, most of the assumptions that are currently being used to do this type of analysis would not have been thought plausible 5 years ago. Problems also exist with the identification and consistent use of assumptions to perform the appropriate type of analysis. FirstCorp supports additional rule making, as long as it can be done consistently at a reasonable cost that will ultimately reduce credit risk exposure, as NEV modeling has done for overall duration mismatch.

State Chartered Corporate Credit Unions

NCUA Rules and Regulations Part 704 for Corporate Credit Unions section 704.17(c) states, "*NCUA will notify, consult with, and provide explanation to the appropriate state supervisory authority before taking administrative action against a state-chartered corporate credit union."*

It is important that NCUA not only acknowledges a State's rights, authorities, and powers, but respects them as well. In reviewing public information, it appears that losses, both realized and unrealized, are concentrated in federally chartered corporates.

The point of my observation is not to imply that realized and unrealized loss amounts would be different absent a dual chartering system. However, the power of taking administrative action should be carried equally by NCUA and the state supervisory authority when considering a state-chartered corporate. Specifically, provision 704.17(c) should be changed to read, "NCUA will notify, consult with, and obtain agreement in writing from *the appropriate state supervisory authority before taking administrative action against a state-chartered corporate credit union."*

Corporate Governance

Surely there were a few pundits in the world predicting our current dismal global economic state. Managers and volunteers at credit unions and corporate credit unions, and federal and state regulators, all share in the blame for the capital erosion that takes place at a given entity. However, bringing on so-called experts from Wall Street or other Fortune 500 companies or anywhere else would not be an improvement. Many former Wall Street company employees now need jobs, and how much did they cost shareholders of companies that no longer exist? How much did they cost taxpayers? Or should I be asking how much will they cost taxpayers by the time the government has completed its bailout process? Including so called "experts" on governing bodies may have caused even more losses within the credit union industry.

Summary

Credit risk being underestimated and this risk being highly concentrated in any one organization, has caused the losses and potential losses at corporate credit unions and entities around the globe. These two areas should be the focus of any revisions to regulatory provisions. Simply eliminating the Corporate Network does more harm than good. Those credit unions choosing to access services from entities other than corporates will continue to have that option. However, those credit unions choosing to determine the future of a corporate that they own should maintain that authority.

We at FirstCorp agree that investment credit risk and the concentration of this risk must be addressed via regulation. However, any restructuring of the Corporate Network should be dictated by natural person credit union leadership. They should make the decisions ranging form whether to abolish the entire corporate network to making minor adjustments to their corporate, not the regulator.

Regards,

Pete Pritts

Pete Pritts, President/CEO