APR07'09 PM 2:11 BOARD

FIRSTDAY
FINANCIAL
FEDERAL CREDIT UNION

March 30, 2009

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

Re: Advanced Notice of Proposed Rulemaking to 12 CFR part 704

Dear Ms. Rupp:

This letter is in response to the recently issued ANPR regarding the structure and nature of the corporate credit union system. Unfortunately, it appears that the ANPR places the lion's share of the blame for the current situation almost exclusively on the backs of the corporate credit unions. While it is clear that there were some failings in management and governance at those corporate credit unions, it is equally clear that regulatory oversight fell short as well.

As the NCUA scrutinizes the regulatory structure under which corporate credit unions will operate, the NCUA should spend significant time evaluating its own procedures and examiner recruitment and training processes. Improved examiner training might have identified problem areas prior to those problems becoming so severe. All too often examiners rely exclusively on "what the books say" rather than gaining a full understanding of the unique environment in which an individual credit union operates. In effect, not all credit unions are created equal – this includes the corporate credit unions.

A heavy dose of real world experience for front line examiners would provide a perspective on the operational issues that a textbook or classroom simply cannot equal. For example, a requirement that examiners have 3 – 5 years of management experience in a credit union or bank would give a solid foundation for the examination process.

As for the ANPR, the Agency raised a number of questions regarding a wide range of issues facing the credit union system. Those questions ranged from the role of corporate credit unions in the system to their capital structure to their board make-up and governance. The challenge for the NCUA at this point is not to overreact to the situation, yet tweak the system enough that future problems can be mitigated.

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1. The Role of Corporates in the Credit Union System.

As we all know, the corporate credit unions were intended to provide products and services to natural person credit unions at a cost that they could simply not achieve on their own. However, for this to occur efficiently, each corporate must be able to independently achieve some economies of scale. This allows the cost savings for such things as check clearing, ACH processing, ATM processing, and effective investment services to be passed on to the natural person credit unions as well as provide for the liquidity needs of their members.

The ANPR questions whether the corporate system should be restructured to segregate the risks associated with the various business lines. Frankly, this would seem an unreasonable response to the situation given that financial institutions, including corporate credit unions, are in the business of managing risk. Natural person credit unions balance the risks associated with delinquencies, fraud, credit, liquidity, interest rates fluctuations, and a dozen other factors every day. This is the way the system works.

A better response to the situation would be to expect corporate credit unions to employ proper risk management techniques. The problems that have been brewing for quite a while, and their resulting losses, seem to be centered on a heavy concentration in one specific asset classification – mortgage backed securities. This violates a basic technique of proper investing – diversify, diversify, diversify.

A second, but very major consideration, regarding separating various functional components of the corporate credit unions is the effect it would have in cost for services. Clearly a major benefit of the current structure is the economy it provides. Adding more players into the system would almost certainly reduce or perhaps even eliminate the economic benefits provided by the corporate credit unions. In addition, if the problem is poor investment strategies, those problems would still exist regardless of the ancillary services provided.

As for the current two-tiered system – having the second layer seems inefficient. Both the retail corporate credit unions and the wholesale corporate are required to maintain capital and need a certain level of infrastructure such as buildings, staff, and equipment. Each of these adds costs to the system which result in ever tightening investment yield spreads. Just as an individual financial institution achieves economies of scale through size and efficiency, an individual corporate can as well. If that is true, then a second level corporate may do little more than drive up expense.

2. Corporate Capital

The most appropriate methodology for determining capital adequacy would be to combine a risk based weighting system with expanded investment authority along with products and services offered by the corporate credit union. In this manner, corporate credit unions with higher investment authority would require higher levels of capital than those with lower investment authority. In addition, corporate credit unions with expanded product lines would need to maintain higher capital levels than those with limited product lines. This approach would focus corporate credit unions' attention to risk management techniques, which would necessarily reduce exposure to unsafe and unsound practices. That reduced risk profile would then radiate to the entire system reducing NCUSIF exposure, thereby protecting against a repeat of recent events.

3. Permissible Investment

The premise here appears to be that the expanded investment authority was the underlying cause of the recent problems – this is not necessarily correct. In fact, solid risk management techniques would have mitigated some of the losses. Therefore, a more appropriate methodology would be to require caps on the asset types based on their underlying collateral. While hindsight is always 20/20, a common sense approach for any financial institution (or company for that matter) would be to diversify their investment portfolio, regardless of their investment authority. That diversification should include asset, security and issuer classifications.

Expanded investment authority should then come with even more strings attached. For example, those corporate credit unions with higher authority levels should be required to stratify their investment portfolios into security type, asset classification and issuer, with caps then specifically tied to their asset liability management strategy. Taking this one step further, the expanded investment authority should then drive the capital requirements.

4. Credit Risk Management

As previously stated, a balanced portfolio is essential to maintaining a proper risk management program. Concentration risk was an underlying cause of the Savings & Loan crisis in the '80s and clearly has played a part in recent problems.

The question surrounding the use of Nationally Recognized Statistical Rating Organizations (NRSRO's) seems more challenging. Prior to the recent events there appeared to be no reason to doubt the validity of the ratings provided; now that does not appear to be the case. This would seem to be a regulatory failure, but not necessarily one that can be fixed by the NCUA. Rather, it would likely require SEC involvement (and Congressional intervention if necessary) to force a greater separation between these agencies and the companies they rate. Recognizing that there clearly is a flaw in the system, however, necessitates NCUA action to regulate the use of these agency ratings by corporate credit unions until appropriate regulatory oversight can be achieved. In the short term, it would seem reasonable that the NCUA require that a corporate credit union review ratings from multiple NRSROs prior to investing in a security. It would also seem natural to require the corporate credit union to independently evaluate the information provided by the NRSRO to ensure reasonableness for the rating(s).

5. Corporate Governance

This too is a complicated issue that goes far beyond the challenges recently faced by corporate credit unions and into the boardrooms of the natural person credit unions as well. Credit unions were founded on the idea of a cooperative spirit and the belief that collectively we are stronger than we are individually. It gave the governance authority to officials democratically elected by the membership. Each member gets one vote regardless of the balance in their account or their economic situation. This stands in stark contrast to other financial institutions that put their governance in the hands of stockholder-elected officers who are, more often than not, management cronies handpicked to ensure the survival of the senior executives and not necessarily the organization.

Everyone would likely agree that the credit union concept is great; however, the practice is a bit more problematic in a world where the economic landscape and challenges credit unions face change almost daily. An even greater burden is being placed on boards to understand these complex economic problems and, it is hoped, make an informed decision on those problems. In the case of natural person credit unions, it is perfectly reasonable for boards to lean heavily on their management team for guidance.

This therefore begs the question, is that also true for corporate credit unions? Not likely. The boards of corporate credit unions are made up of executives from within the industry. These are individuals who are likely running their own natural person credit unions, or in the case of US Central, running a corporate credit union. The ANPR requested comments on whether there should be minimum standards set for corporate directors. Shouldn't these individuals already meet those minimums by virtue of the fact that they are executives significantly involved in running other credit unions? If not, should they even be running their own shops?

Obviously, the concepts corporate credit unions deal with are complex. However, these concepts are no less complex than those dealt with every day by credit union executives, including the ones sitting on these boards. With all this said, there are a few changes that should be considered with regards to the board make-up for all credit unions. Those include:

- Term limits – directors should be limited to two consecutive terms to ensure adequate representation of the membership as a whole. Term limits would also help ensure that directors maintain a level of independence and reduce the likelihood for "cronyism."

- Minimum standards – given the challenges faced in a modern economy, it seems reasonable that minimum standards for directors be established. The understanding of those minimum standards should be documentable and based on the complexity of the credit union's product and service lines.

- Pay – credit unions were built on the cooperative spirit of the membership and should be represented by boards who reflect that spirit. However, once minimum standards are set for directors it may also be appropriate to permit some compensation for those directors to recognize their commitment to the organization. This compensation should be closely regulated and should NOT be based on asset size or number of products offered, as this could lead to unsafe practices. Instead, maximum compensation amounts should be a function of the number of years of service (with term limits imposed), and not exceed some nominal amount such as $100 to $200 per month.

- Transparency in executive compensation – this is always a difficult subject to tackle. Given the current economic climate, it is certainly challenging to justify CEO salaries that are, in some cases, hundreds of times higher than that of the average employee in their company. However, this is not necessarily the situation with credit union executive pay. Clearly credit union CEOs make less than their banking counterparts, which begs the question regarding the motivating factors involved in requiring "transparency." In many credit unions (certainly the smaller ones), the person in charge earns only a few times more than the average employee and rarely gets lofty perks beyond the benefits offered to other employees. A more sensible approach would be to ask a question on the Call Report regarding executive compensation based on the average compensation for employees at the credit union. This would allow for some privacy with regard to this sensitive subject, yet still demonstrate that executive compensation is not out of line with the pay for the balance of the employees at an organization.

- Outside directors – the problem with an "outside" director is in who chooses the individual. If the management team is tasked with finding this "independent" individual, how likely is it that they will indeed be independent? Also, being an "outside" director does not guarantee the individual has any greater understanding of the issues than those directors coming from the credit unions. While this concept might have some validity to it, the practice would be difficult to regulate, and it seems there is little guarantee it would resolve any of the problems faced by the corporate credit unions.

FirstDay Federal Credit Union has an asset base of $84 million as of February 2009. FirstDay began operations in 1935 servicing the needs of teachers in the Dayton Public School system, but now has four branch offices serving individuals who live, work, worship, and attend school in Montgomery, Preble, Greene, and Miami counties in southwestern Ohio.

The management and board are particularly proud of the fact that FirstDay provides service in areas that would certainly qualify as "underserved." Specifically, FirstDay is the ONLY financial institution with an office on Main Street from just outside the downtown area until just inside the northern city limit. This credit union has made the commitment to the people who live in this underserved community and plans to remain there providing financial services for a long time to come.

FirstDay's commitment to our community goes far beyond simply providing financial products and services. Our staff has held car washes to raise money for school supplies that were then given to underprivileged students. The staff "adopts" local families during the holiday season and donates both gifts and food. The staff also has held fundraisers where the proceeds go to help the local homeless shelter. Simply put, FirstDay believes in the cooperative spirit upon which credit unions were founded.

As for our involvement with the corporate credit unions, we have used the products and services provided by Corporate One for many years. While few of the corporate credit unions have been unaffected by the financial challenges facing the country, Corporate One has always provided excellent service and seems to have done a reasonable job managing their exposure to the current market. We strongly believe that Corporate One has worked hard to help ensure their members have quality products and services while balancing the market risks.

Thank you for your time reviewing these comments.

Sincerely,

Lee Spivey
President/CEO