Corporate One
FEDERAL CREDIT UNION

January 5, 2015

Mr. Gerard Poliquin
Secretary of the Board
National Credit Union Administration
1775 Duke St
Alexandria, VA 22314-3428

RE: Comments on Proposed Rule – Corporate Credit Unions

Dear Mr. Poliquin,

We appreciate the opportunity to comment on the proposed changes to 12 CFR Part 704 Rules and Regulations for corporate credit unions. As noted in the summary of the proposed rule, the proposal clarifies certain mechanics of a number of substantive regulatory provisions and makes several non-substantive, technical corrections. Overall, we concur with all of the proposed changes. However, we have identified a few additional items that we believe are either in need of a technical correction or are changes we wish to bring to the attention of the NCUA Board for consideration. We understand that these items are not included in the proposed rule, however, we respectfully ask for their serious consideration. As a corporate credit union, we are focused on providing important payment, liquidity and investment services to our member credit unions. We believe that our recommendations enhance our ability to provide these services without significantly increasing the risks. Our comments are respectfully submitted below.

Substantive Issues Not Addressed in the Proposed Rule

1. **704.8(h) Weighted Average Life (WAL) Treatment for Government Issued or Guaranteed Securities**

   NCUA Rules and Regulations Part 704.8(h) states the following: Government issued or guaranteed securities. The WAL of investments that are issued or fully guaranteed as to principal and interest by the U.S. Government, its agencies or sponsored enterprises, including investments that are fully insured or guaranteed (including accumulated dividends and interest) by the NCUSIF or the Federal Deposit Insurance Corporation, will be multiplied by a factor of .50 for purposes of the WAL tests of paragraphs (f) and (g) of this section.

Per the current rule, a corporate is to manage their financial assets to maintain a WAL of 2 years or less to be measured at month-end in the base case, and 2.25 years or less to be measured at month-end in a 50% prepayment speed slowdown scenario. U.S. Government issued or guaranteed securities (Part 704.8 (h)) are allowed a modest WAL benefit in the rule, as the WAL for this type of security is given a one-half WAL treatment.

Government guaranteed securities exhibit no credit risk, are highly liquid in the marketplace, serve as a buffer in economic stress scenarios, and are valuable collateral for liquidity in the capital markets and at the Federal Reserve Bank. Accordingly, we believe that the one-half WAL treatment is not enough of a benefit or incentive for buying these securities. We think the factor included in section 704.8 (h) should be weighted as a cash equivalent.

We are not recommending that the NCUA Board revise the WAL measurement for credit related securities, NCUA Rules and Regulations Part 704.8(f) and Part 704.8(g), but we are recommending an exclusion of government guaranteed securities from this risk measurement in NCUA Rules and Regulations Part 704.8(h). We believe it is technically incorrect to assign WAL limits on government guaranteed instruments. A clear example of the shortcomings of this rule and a discussion of the unintended consequence follows:

> A corporate with a balance sheet comprised primarily of 6 year floating rate agency securities and sufficient cash for liquidity, would violate the current WAL limitation, despite having no credit risk, limited liquidity risk and modest interest rate risk. Because the amount of cash needed in this example to bring the WAL below 2 years would significantly reduce the net interest income on this predominately government guaranteed portfolio, an investment portfolio manager may be incented to invest deposits in shorter WAL securities, such as asset-backed securities (ABS). The asset allocation of the shorter WAL portfolio has a higher net interest income, but also has a much higher exposure to credit and liquidity risks in comparison. The rapid deterioration in market values and liquidity during the most recent 2008-2009 economic crisis in the ABS market is evidence that despite the shorter average life the inherent risks in these securities are significantly greater than the risks in government guaranteed securities. For this reason, we strongly feel that the agency should provide a full discount or a 0 factor for government guaranteed securities in calculating the

WAL; hence, providing a strong incentive for portfolio managers to invest in highly liquid, government guaranteed securities.

We acknowledge that longer WAL government guaranteed securities may exhibit more interest rate risk than credit exposed shorter WAL securities, but the NEV ratio and NEV impairment testing required within NCUA Rules and Regulation Part 704.8(d) already capture and limit the amount of interest rate risk a corporate credit union is permitted to take.

Requested Solution. We respectfully request that section 704.8(h) be modified to multiply the WAL of government issued or guaranteed securities by a factor of zero. Further, we ask that all asset-backed securities comprised of collateral issued or insured by the US Government, or one of its Agencies, be provided a WAL treatment similar to government securities, up to the portion of the collateral that is guaranteed.

2. 704.2 Definitions – Tier 1 Capital – Requirement to Deduct Perpetual Contributed Capital (PCC) in 2016

What used to be called “adjusted core capital” and is re-named in the proposed rule “tier 1 capital” requires that: (8) Beginning on October 20, 2016, and ending on October 20, 2020, deduct any amount of PCC that causes PCC minus retained earnings, all divided by moving daily net average assets (DANA), to exceed two percent.

Our understanding is that the formula was written this way to incent corporate credit unions to grow their retained earnings. However, we believe that the formula is technically incorrect. The formula actually allows a corporate with a lower retained earnings ratio to have a greater percentage of its tier 1 capital made up of PCC. The example below illustrates the ratios of three corporates with the same amount of PCC and the same total DANA, but varying levels of retained earnings. In the example shown, Corporate B has the lowest amount of retained earnings and yet its tier 1 capital is made up of the highest amount of PCC on a percentage basis. Whereas, Corporate C has the highest amount of retained earnings and its tier 1 capital is made up of the lowest amount of PCC on a percentage basis. In other words, the tier 1 capital of Corporate B is made up of 75% PCC whereas the tier 1 capital of Corporate C is only 66% PCC even though this corporate has more retained earnings.

	Corporate A		Corporate B		Corprorate C	
PCC	$	218,000,000	$	218,000,000	$	218,000,000
Retained earnings (RE)	$	55,000,000	$	38,000,000	$	80,000,000
DANA	$	3,700,000,000	$	3,700,000,000	$	3,700,000,000
RUDE Ratio		1.49%		1.03%		2.16%
PCC-RE	$	163,000,000	$	180,000,000	$	138,000,000
2% DANA	$	74,000,000	$	74,000,000	$	74,000,000
cap>2%	$	89,000,000	$	106,000,000	$	64,000,000
PCC counted as Tier 1 capital	$	129,000,000	$	112,000,000	$	154,000,000
retained earnings	$	55,000,000	$	38,000,000	$	80,000,000
Total Tier 1 capital	$	184,000,000	$	150,000,000	$	234,000,000
2016 Permanent Leverage Ratio		4.97%		4.05%		6.32%
Total PCC + RE as a percentage of DANA		7.38%		6.92%		8.05%
Portion of numerator made up of PCC		70%		75%		66%
Portion of numerator made up of RE		30%		25%		34%

Requested Solution: We respectfully request item 8 of the definition of tier 1 capital in the proposed regulation be deleted as a technical correction.

3. 704.2 Definitions: Tier 1 Capital – Requirement to Deduct PCC in 2020

Perpetual Contributed Capital (PCC) is defined in the Regulation 704 as perpetual, non-cumulative dividend accounts that are available to cover losses exceeding retained earnings and are considered equity under generally accepted accounting principles, or GAAP. This capital contribution is a permanent capital instrument for a corporate credit union funded by its member credit unions. This type of capital is the regulatory equivalent of non-cumulative perpetual preferred stock as defined by the FDIC regulations, which is consistent with the definition of "Tier 1" or "core capital" by the banking regulatory agencies, the Securities Exchange Commission and the United States Treasury.

The definition of tier 1 capital includes two items - #8 and #9 that reduce the amount of PCC that can be counted as part of tier 1 capital starting in October 2016 and then more severely in October 2020, despite the fact that they remain perpetual forms of capital for the corporates. Credit unions that invested in PCC at their corporate did so to ensure that they would continue to receive competitively priced investment, liquidity, and payment services from their corporate well into the future. No other financial regulator excludes any portion of permanent capital, non-cumulative perpetual preferred stock, or other similar permanently contributed capital in the calculation of core capital.

One major unintended consequence of the reduction of PCC that can be included as part of Tier 1 capital after 2016 is how third parties including: the Federal Reserve Banks, the credit rating agencies, other creditors, financial institution business partners, and auditors view our capital strength. These third parties are all important constituencies that can impact how we provide services to our member credit unions. Most will look at regulatory capital as opposed to GAAP capital since our ability to operate is based on our regulatory capital. Every corporate will see its Tier 1 capital levels and ratios drop significantly in October 2016 and even more dramatically in October 2020 despite the fact that our overall capital will be much stronger due to years of building retained earnings. We do not view the PCC deductions as beneficial to the credit union network and feel that it actually diminishes our ability to provide maximum effective services to those credit unions that contributed perpetual capital.

The regulation also does not provide for a comparable capital ratio measure between corporates. The permanent leverage ratio is one of the most critical capital ratios for a corporate to meet and can lead to prompt corrective action if not held at the adequately capitalized level. However, two corporates can have the same permanent leverage ratio even if one has significantly more capital than the other. To illustrate this point, see the example below where Corporate A and B have the same amount of retained earnings and DANA; however, Corporate A has significantly more PCC than Corporate B. Corporate A has total capital of $273 million to protect members, creditors and the share insurance fund against losses whereas Corporate B only has $184 million. However, the permanent leverage ratio for both corporates is the same at 4.97%. Based on the permanent leverage ratio, it would appear that both corporates have equal protection against losses, when in reality there is $89 million more capital to protect member deposits, creditors and the share insurance fund with Corporate A.

	Corporate A	Corporate B
PCC	$ 218,000,000	$ 129,000,000
Retained Earnings (RE)	$ 55,000,000	$ 55,000,000
DANA	$ 3,700,000,000	$ 3,700,000,000
RE Ratio	1.49%	1.49%
PCC-RE	$ 163,000,000	$ 74,000,000
2% DANA	$ 74,000,000	$ 74,000,000
cap>2%	$ 89,000,000	$ -
PCC counted as Tier 1 capital	$ 129,000,000	$ 129,000,000
RE	$ 55,000,000	$ 55,000,000
Total Tier 1 capital	$ 184,000,000	$ 184,000,000
PCC in Permanent Leverage Ratio	59.17%	100.00%
2016 Permanent Leverage Ratio	4.97%	4.97%
Total PCC + RE as a percentage of DANA	7.38%	4.97%

Requested Solution:
We respectfully request item 9 of the definition of tier 1 capital in the proposed regulation be deleted. We also reiterate the requested solution from our second comment above that item 8 of the definition of tier 1 capital in the proposed regulation be deleted.

4. Section 704.5 Investments

Our ability to invest in Government Sponsored Entity (GSE) mortgage-backed securities is currently permitted via section 704(c)(1), where it refers to the Federal Credit Union Act as to our permissibility of agency securities: (1) Securities, deposits, and obligations set forth in Sections 107(7), 107(8), and 107(15) of the Federal Credit Union Act, 12 U.S.C. 1757(7), 1757(8), and 1757(15), except as provided in this section;

The Federal Credit Union Act 1757(7)(c) states as it relates to agency securities: in obligations of the United States of America, or securities fully guaranteed as to principal and interest...

This definition was based on how agency securities were issued in the past. However, the financial crisis and the regulations that continue to be re-written are expected to change how GSE mortgage-backed securities are issued in the future. It appears highly likely that at some point in the future most, if not all, GSE mortgage-backed securities will have some form of credit sharing with investors. If we are not permitted to purchase any of the credit sharing deals in the future, we will not be able to provide any type of liquidity to the mortgage market (this would hold true for natural person credit unions as well). Current regulation does not permit corporates the ability to participate in an agency risk sharing structure even if we purchased a senior tranche because the deal has be to be 100% guaranteed by a GSE.

Under Dodd-Frank, the GSE's are being forced to create risk sharing structures and to date they have only issued subordinate certificates in which the performance and cash flows are tied to a pool of mortgage collateral (we are not requesting permission to purchase these securities since they are rated below AAA). That said, our understanding is that the GSE’s are also being forced to structure other types of deals, such as insured, senior/sub, etc. The following is a quote from a Barclay’s research piece:

> "The FHFA has set a $90 billion target for risk transfer in 2014. Each enterprise must utilize at least one transaction type in addition to the STACR or CAS structures (e.g., insurance, upfront credit risk transfers, and senior/subordinated securitizations). FHFA will provide extra scorecard credit for completing any additional types of transactions beyond the first two. This suggests that risk transfers other than CAS/STACR and insurance policies (senior-sub, for example) are likely." *The STACR and CAS are FNMA and FHLMC's subordinate certificates that have been issued to date.*

If Regulation 704 is not modified, we believe we will have very limited access to government issued mortgage-backed securities. As you know, the mortgage market is big part of our economy and in an indirect way a big part of how we can provide liquidity to credit unions that sell to the GSE's. We realize that the GSE's have not created all the various structures yet so it is difficult to request approval; however, we ask that NCUA consider this market as permissible for corporate credit unions when the market is defined.

Requested solution:
As the GSE mortgage-backed securities are currently being re-structured and may no longer meet the definition as defined in the Federal Credit Union Act, we ask that NCUA consider adding to 704.5(c)(1) "or a senior tranche of a credit risk sharing GSE security as long as it has no more than a minimal amount of credit risk."

The following comments are directed as specific to the Proposed Rule:

704.8(j) NEV-related measures including the weighted average life

We strongly support the fact that the wording in 704.8(j) needs clarification. As presently written, the regulation is unclear as to when a WAL violation occurs. The regulation appears to provide for a 10 day cure period, and if corrected within this time period a corporate is not required to report the violation to its Board of Directors or the NCUA. Given the corporates' role as payment providers to our member credit unions, there are significant fluctuations in share balances throughout the month. On Fridays, for example, there are large inflows of shares from incoming ACH, while midweek there are large outflows due to outgoing ACH and sharedraft clearings. The fluctuations in shares have a direct and corresponding effect on the cash of a corporate credit union. As a result, the WAL of a corporate's assets fluctuates significantly based simply on which day of the week the month or quarter ends. The snapshot at month-end for the WAL calculation is a highly volatile measure that is simply more dependent on the specific day of measurement versus the risk inherent in the underlying portfolio.

Within 704.8(j), the regulation already provides 10 days for a corporate credit union to adjust the balance sheet to satisfy the requirements of the WAL and other NEV-related measurements. The clarification in the proposed rule recognizes the role corporates play with respect to payments processing and reiterates that the 10 days is part of the testing period. The regulation was obviously written to address the volatility in the WAL and other NEV-related measures due to the specific day of the week that the testing occurs.

A real life example of this timing issue was found in our WAL calculations for March and April 2014. Our WAL increased from 1.90 years on March 31 to 2.13 years on April 30, 2014. The primary change during this time period was the fact that our cash balance at March month-end, a Friday, was $1.9 billion and at April month-end, a Wednesday, cash declined to $1.3 billion. However, on Thursday, May 1st, our cash balance increased to $1.76 billion and, on May 2nd, the cash balance increased further to $2.1 billion. Therefore without this clarification it may be assumed we failed the test as of month-end, and then passed the test the next day going from a 2.13 year WAL on April 30th to a 1.88 year WAL on May 1st. One day made a significant difference in the WAL calculation simply due to volatility in settlement payments throughout a weekly period.

As the 10-day "cure" period was obviously contemplated, and as corporates have been encouraged by the NCUA to become more liquid and more focused on settlement payments, we need a practical solution that addresses the volatility in settlement dollars resulting from the day of the week the testing occurs. These significant deposit fluctuations as a result of the day of the week that the month-end falls renders a WAL measurement based on a snapshot of one day an inappropriate regulatory tool, especially one for which prompt corrective action can be invoked.

We support the rule clarification as proposed.

704.9(b)(1) Secured Borrowings

This section had a strict prohibition on secured borrowing for a period greater than 30 days. Our understanding is that the basis for this was to avoid the use of borrowing to finance long-term assets. However, as a practical matter the 30-day limit creates an unintended risk by severely restricting a corporate's ability to fund seasonal outflows of liquidity and it also eliminates a source of liquidity to the credit union system if faced with a severe liquidity event. The proposed rule increases the maximum borrowing limit from 30 days to 120 days; however we believe this should be longer. More frequently we are being tasked with finding solutions for our members' funding needs. The 120 day secured borrowing limit severely restricts our ability to match fund our credit unions' liquidity needs. We believe a more appropriate time frame would be 2 years. Additionally, as evidenced during the liquidity crisis of 2008 – 2009, there can be periods where longer borrowings can be necessary and appropriate. Therefore, we believe the rule should be amended to give the NCUA Board the ability to suspend the limitations found in this section in the event of a liquidity or network crisis.

Requested solution: We support a rule change for Section 704.9(b)(1) and request NCUA extend the limit from the currently proposed 120 days to 2 years. We also suggest that this section be enhanced to provide for the NCUA Board or Office of National Examinations and Supervision (ONEs) to suspend the rule to allow for longer secured borrowing periods in order to support a systemic liquidity event.

Corporate One FCU appreciates the opportunity to comment on the proposed rule.

Respectfully Submitted,

Lee C. Butke
President/CEO

cc: Board of Directors, Corporate One FCU