

NCUA Proposed Rule Part 704 for Corporate Credit Unions

Regulation Analysis

and arguments to change certain parts of the Proposed Rule

December 22, 2009

WESCORP. 

Introduction

The NCUA's Proposed Rule for Corporate Credit Unions, if enacted as currently drafted, has a number of elements that would have a detrimental impact to the nation's credit unions.

The task faced by the NCUA in this rewrite was indeed a daunting one. Following one of the biggest financial events in the history of credit unions, the NCUA has been challenged to re-regulate the wholesale corporate system, both structurally, and limitationally. They must somehow find that line all regulators seek: the delicate balance between *too big to fail*, and *too regulated to succeed*. They must tighten up all rules of engagement, from capital to risk, from governance to operations. They must somehow do this and still allow their stated objective: The NCUA has said, "We'll dictate the safety and soundness conditions to protect the system; you, natural persons, decide if you want a corporate system." Their revision of this rule must somehow allow for this statement to be true.

Not spoken, but implied, is a condition that the rules must allow a corporate—as a financial institution, a system-owned financial intermediary—to take enough appropriately compensated risk to build retained earnings, attract deposits, and invest in the technology and scale building initiatives necessary to serve credit unions. That's the fine line the NCUA must define: not enough risk to repeat what we just went through, but enough to justify a sound business model worthy of your future patronage and capital support.

The new Proposed Rule document is 253 pages long and contains some big, sweeping changes. Since the draft is so lengthy and complex, we believe the best approach is to draw your attention to those areas we consider most onerous to credit unions.

We will focus only on the most critical elements of this proposed new rule, those that directly affect your operations, or affect WesCorp so fundamentally that your life will change as a result of what happens to us.

Introduction *continued*

What did the NCUA change, and how will it protect the system? There are several broad measures:

- Sector concentration portfolio limits
- Taboo on certain securities (high-risk assets)
- Risk-weighted capital requirements. More risk, more capital.
- Assets limited to two years average
- Retained earnings growth required

These seem very reasonable goals. However, do they pass a practicality test that would allow corporate credit unions to generate reasonable returns? Or must the corporate credit union significantly increase the fees paid by its member credit unions and/or reduce service levels to be able to support needed products and services?

In our judgment, there are a several parts of the new rule that do not retard risk much more than is already taken out by other limits, but that do severely disallow a corporate credit union to take measured, considered risk and earn a sufficient return to stay in business. Those areas are the focus of this white paper and will be discussed in something close to what we consider their order of importance. In each case, we will present you with an analysis of the change, its likely impact to credit unions and our recommendation for your comment to the NCUA by their deadline of March 9, 2010.

Analysis of Selected Sections:

Section:

704.8 – Asset and liability management

(c) Penalty for early withdrawals (page 180)

A corporate credit union that permits early share certificate withdrawals must redeem at the lesser of book value plus accrued dividends or the value based on a market-based penalty sufficient to cover the estimated replacement cost of the certificate redeemed. This means the minimum penalty must be reasonably related to the rate that the corporate credit union would be required to offer to attract funds for a similar term with similar characteristics.

Analysis:

The elimination of the ability for a corporate credit union to redeem one of its certificates at a premium puts the issuance of share certificates by corporate credit unions at a significant disadvantage, and will likely destroy or make non-economical, the institutional funding market for term certificates.

Corporate share certificates are a direct competitor to U. S. Agency issued debt. Corporates have been able to compete effectively by comparing the two investment alternatives. They pay a higher yield to investors and can be structured to exactly meet investor needs rather than take whatever the Agency market happens to be offering. In terms of collateral value, they may assign 100 cents on the dollar regardless of market value, whereas Agency debt is assigned a percentage of the prevailing market value. As far as liquidity goes, both can be “sold” at prevailing market prices.

The proposal limits a corporate credit union’s ability to pay a market based redemption price to no more than par, thus eliminating the ability to pay a premium on early withdrawals.

By removing the comparable liquidity option, all corporate certificates are at a distinct disadvantage that brokers will be very quick to point out to investors.

continued...

Section:

704.8 (c) – Penalty for early withdrawals (page 180) - continued

Impact:

Adopting this proposal will have the impact of significantly reducing overall liquidity in the corporate credit union system as brokers of Agency securities stress that the yield pick-up is inadequate to cover the credit risk and the lack of liquidity. Corporates will not be in a position to counter that argument by increasing the spread differential, because investment restrictions will make such issuance totally unprofitable.

For WesCorp, longer-term fixed-rate certificates are synthetically converted to floating-rate through interest rate swaps. When a certificate is tendered for early redemption, any associated swap is cancelled with a marked to market cash settlement amount. Where the certificate holder incurs a loss (a market value price below par) the cost of redemption is used to pay the swap counterparty cancellation costs. Where the certificate holder is “in the money” (a market value price above par) the swap counterparty pays WesCorp an early termination fee. This fee, under current operating guidelines, is be used to pay the premium payable to the certificate holder. In situations where no swap is associated with an “in the money” certificate offered for redemption, WesCorp will earn that fee back by paying lower funding costs going forward.

It seems somewhat incongruous that WesCorp should take windfall profits from its owners who may have very legitimate reasons to need the proceeds from a certificate redemption.

Credit unions will lose a competitive investing option (at some spread to federal agency debt) for their spare unloaned deposits.

continued...

Section:

***704.8 (c) – Penalty for early
withdrawals (page 180) -
continued***

We recommend:

This proposal, if indeed a misguided attempt to insure system liquidity, will have the opposite effect as well as prevent the emergence of a sound funding strategy for all corporates. It is strongly urged that this proposal be stricken from the final rule.

Section:

704.8 (d) – Interest rate sensitivity analysis (page 180)

(1) A corporate credit union must:

(i) Evaluate the risk on its balance sheet by measuring, at least quarterly, the impact of an instantaneous, permanent, and parallel shock in the yield curve of plus and minus 100, 200, and 300 bp on its NEV and NEV ratio. If the base case NEV ratio falls below 3 percent at the last testing date, these tests must be calculated at least monthly until the base case ratio again exceeds 3 percent;

(ii) Limit its risk exposure to levels that do not result in a base case NEV ratio or any NEV ratio resulting from the tests set forth in paragraph (d)(1)(i) of this section below 2 percent; and

(iii) Limit its risk exposure to levels that do not result in a decline in NEV of more than 15 percent.

Analysis:

The rule on NEV shock testing to control interest rate risk has been in effect for those corporate credit unions that have expanded authorities and basically has proved to be a valuable control point for interest rate risk since its inception some 12 years ago. The 3 percent threshold does reduce the amount of analysis for those corporates that do not seek to take interest rate risk, whereas the old rule required monthly testing regardless of the results of the previous test.

continued...

Section:

704.8 (d) – Interest rate sensitivity analysis (page 180) – continued

(2) A corporate credit union must assess annually if it should conduct periodic additional tests to address market factors that may materially impact that corporate credit union’s NEV. These factors should include, but are not limited to, the following:

(i) Changes in the shape of the yield curve;

(ii) Adjustments to prepayment projections used for amortizing securities to consider the impact of significantly faster/slower prepayment speeds; and

(iii) Adjustments to volatility assumptions to consider the impact that changing volatilities have on embedded option values.

Impact:

No change to existing operational requirements and controls.

We recommend:

This section stays as published.

Section:

704.8 (e) – Cash flow mismatch sensitivity analysis (page 181)

(1) A corporate credit union must:

(i) Evaluate the risk on its balance sheet by measuring, at least quarterly, the impact of an instantaneous spread widening of both assets and liabilities by 300 basis points, assuming that issuer options will not be exercised, on its NEV and NEV ratio. If the base case NEV ratio falls below 3 percent at the last testing date, these tests must be calculated at least monthly until the base case ratio again exceeds 3 percent;

(ii) Limit its risk exposure to levels that do not result in a base case NEV ratio or any NEV ratio resulting from the tests set forth in paragraph (e)(1)(i) of this section below 2 percent; and

(iii) Limit its risk exposure to levels that do not result in a decline in NEV of more than 15 percent.

(2) All investments must be tested, excluding derivatives and equity investments. All borrowings and shares must be tested, but not contributed capital.

(3) A corporate credit union must also test for the effects of failed triggers on its NEV and NEV ratios while testing the cash flow sensitivity analysis.

Analysis:

This appears to be a knee jerk reaction the recent events and the resulting freezing of credit markets. It amounts to setting limits based upon a once-in-a-lifetime, totally unexpected event. The spread widening of 300 basis points coupled with a decline limited to 15 percent is too restrictive and will severely hamper a credit union from generating net interest income.

For fixed-rate instruments, this will increase the amount of risk assigned, as the same 300 bps decline will be discounted at a lower rate in the credit shock environment. This will add from 1% to 15% additional volatility to a fixed rate instrument depending on remaining tenor. For floating-rate instruments, the impact will be much more significant. The credit spread shock will apply to the entire life of the floating-rate instrument, effectively converting it to a fixed-rate for measurement purposes. This means that a 1-month floater with a 2-year maturity will have a risk profile of -0.25% in the +300 bps interest rate shock test but will be assigned a -5.97% in the credit spread shock test. Floating-rate instruments are normally attractive investments for a corporate as they react quickly to changes in interest rates giving relatively stable price profiles, but their attractiveness would be eliminated under this test. This means that it is effectively mathematically impossible to have a -5% interest rate risk volatility and pass the -15% credit spread shock test.

Our analyses indicate that there is no combination of assets, with a 2-year average life and limited extension risk, that could generate sufficient margin to attract funding *and* pass a 300 bps credit shock test.

Also, section 2 clearly rules that derivatives are to be excluded from the shock test even though these are not immune from the impact of credit spread widening. Additionally, the Part III (derivatives expanded authority) specifically allows credit derivatives, which are available to mitigate the very risk being tested! It is inconsistent to allow derivatives that hedge credit spread widening yet disallow those transactions from a credit spread widening shock test.

Section:

704.8 (e) – Cash flow mismatch sensitivity analysis (page 181) - continued

Analysis continued

Historic analysis indicates that 100 bps would be an unusual and rare event in the market sectors that would be allowed under the new regulation. Over the last 15 years, excluding recent events, Credit Card and Auto ABS credit spreads to LIBOR widened to a maximum of around 50 bps, and generated a standard deviation of spread volatility of around 10 bps.

It would seem more realistic to set the credit shock test at 100 bps widening – double the historical average. Even at 100 bps credit shock, a NEV volatility limit of 35% decline is needed to accommodate the impact of floating-rate investments carrying the loss to maturity.

Additionally, there is a significant difference between Agency issued instruments and other non-government guaranteed securities. Debt of Government Sponsored Entities (“GSE”) would not carry concentration limits in the proposed rules. These securities trade in very large and liquid markets. We recommend using a lower credit spread shock, for example 50% of the regular spread shock, for securities issued by GSEs.

Impact:

If this proposal is left unchanged, it will have severe repercussions on the future viability of the corporate credit unions. Any ability to generate a reasonable interest margin to build retained earnings will become very dependent upon a lower cost of funds for the corporate. That means a lower yield paid to members.

Natural person credit unions should also be concerned that if this proposed control is applied to planned revisions to Part 703 regulation, it will have a similar impact on natural person credit unions’ performance.

continued...

Section:

***704.8 (e) – Cash flow
mismatch sensitivity analysis
(page 181) - continued***

We recommend:

You to urge the NCUA to amend this test to a more realistic test of a 100 bps credit spread widening and a 35% NEV volatility tolerance limit, and consider a reduced shock for GSE debt. The role of derivative transactions also needs to be consistent with other parts of the proposed rules. Some consideration should also be given to scaling the credit shock to the weighted average life of GSE issued securities.

Section:

704.8 (f) – Cash flow mismatch sensitivity analysis with 50 percent slowdown in prepayment speeds (page 181)

(1) A corporate credit union must:

(i) Evaluate the risk on its balance sheet by measuring, at least quarterly, the impact of an instantaneous spread widening of both assets and liabilities by 300 basis points, assuming that issuer options will not be exercised, and prepayment speeds will slow by 50 percent, on its NEV and NEV ratio. If the base case NEV ratio falls below 2 percent at the last testing date, these tests must be calculated at least monthly until the base case ratio again exceeds 2 percent;

(ii) Limit its risk exposure to levels that do not result in a base case NEV ratio or any NEV ratio resulting from the tests set forth in paragraph (f)(1)(i) of this section below 1 percent; and

(iii) Limit its risk exposure to levels that do not result in a decline in NEV of more than 25 percent.

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Analysis:

Non-mortgage ABS (Auto, Credit Card, and Student Loan) historical prepayment speeds do change modestly from time to time, but prepayment changes are driven more by the prevailing economic conditions rather than interest rate or credit events. There is no factual or historic basis for halving ABS speeds in the context of a credit risk shock test. Floating-rate, non-mortgage ABS securities are a lower risk, reasonable return investment, of which the corporates' ability to purchase would be severely constrained under this test when the proposed rule already applies concentration limits.

MBS principal paydowns are subject to interest rates and prevailing economic conditions. The portfolio/asset limit of 2 years in weighted average life, along with the credit shock and pay-down slowdown tests will effectively make holdings in MBS (the single largest asset-backed sector) virtually impossible. However, there is clearly a significant difference between private label MBS and Agency-issued MBS. These securities are issued by Government Sponsored Entities and do not carry any concentration limitations in the proposed regulations. To gain access to this market and earn a spread for taking prepayment risk, without taking credit risk, consideration should be given to having separate rules for Agency MBS. Principal pay-down slowing needs to be and is assessed under the interest rate sensitivity analysis. That section also calls for periodic testing of the impact on changes in prepayment speeds but does not assign any resulting limits. For Agency MBS it would be more reasonable if any new test applied a smaller credit shock, for example 50% of the credit shock used for other security types.

Non-mortgage ABS and Agency MBS are lower-risk securities, with a reasonable return, which the credit shock tests will largely exclude from corporate balance sheets under the proposed rules. The return on investment these securities provide will be crucial if corporates are to meet proposed growth targets in Reserves and Undivided Earnings (RUDE).

Section:

704.8 (f) – Cash flow mismatch sensitivity analysis with 50 percent slowdown in prepayment speeds (page 181)- continued

(2) All investments must be tested, excluding derivatives and equity investments. All borrowings and shares must be tested, but not contributed capital.

(3) A corporate credit union must also test for the effects of failed triggers on its NEV and NEV ratios while testing the cash flow sensitivity analysis.

Impact:

If this proposal is left unchanged, it will have severe repercussions on the future viability of the corporate credit unions. The largest sector of potential investments – Agency and Private Label Mortgage Backed Securities – will be effectively closed to corporate balance sheets. The ability to generate a reasonable interest margin will become very dependent upon a lower cost of funds for the corporate. That can only mean a lower yield paid to members.

If this proposed control is applied to planned revisions to Part 703 regulation, it will have a similar impact on natural person credit unions' performance.

We recommend:

You to urge the NCUA abolish this test and rely on the periodic analyses provided for in Section 704.8 (d) 2 (ii) or amend this test to allow a 50% NEV volatility tolerance limit. Some consideration should also be given to scaling the credit shock to the weighted average life of GSE issued securities.

Section:

704.8 (h) – Weighted average asset life (page 182)

The weighted average life (WAL) of a corporate credit union's investment portfolio, excluding derivative contracts and equity investments, may not exceed 2 years. A corporate credit union must test its investments at least quarterly for compliance with this WAL limitation. When calculating its WAL, a corporate credit union must assume that no issuer options will be exercised.

Analysis:

This clause limits the term or weighted average life of a corporate credit union's investments. There are various implications for natural person credit unions from this section of the rule.

Impact:

First, a corporate's ability to make term loans to natural person credit unions beyond two years will be adversely affected. Although not clear in the language of the rule itself, NCUA has stated that the investment portfolio *must* include loans to members and CUSOs. A corporate wishing to make loans to natural person credit unions will have limited choices. In order to keep the overall weighted average life of the portfolio within the two year limit, most of the loans made will be limited to shorter-term maturities. For longer-term loans a corporate credit union will have to increase the rate offered substantially in order to compensate for the impact the longer term will have on this WAL test.

Finally, in order to meet potential lending demand from members, a corporate will have to keep its securities portfolio well under the two-year limit, so as to not have a single loan cause a breach of the limit. The two-year limit is already a severe constriction on Net Interest Income generation. Including loans in the calculation will force a corporate to choose between enough income to survive and being in the term lending business with members.

If the proposed rule is adopted, longer-term financing available to natural person credit unions from corporate credit unions will be reduced drastically and what will be available will come with a much higher borrowing cost.

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Section:

704.8 (h) – Weighted average asset life (page 182) – continued

Impact continued:

A second impact of this part of the proposed regulation is the effect it has on a corporate credit union's ability to earn an adequate yield on its investment portfolio. One way a corporate credit union adds yield to its portfolio is to move out the maturity spectrum. Securities with longer maturities or weighted average lives typically earn higher yields to compensate investors for the additional interest rate risk inherent in the longer term. Much of this interest rate risk can be mitigated through the use of derivatives within a prudent interest rate risk management program. The current NEV testing required of corporate credit unions adequately measures and limits this risk. This WAL restriction will lower the yield a corporate credit union will be able to earn on its portfolio and will lead to lower rates available to natural person credit unions on corporate credit union certificates. We might note that this will be a significant competitive disadvantage to the banking industry; credit unions will be much more restricted in their investing choices than other deposit takers in the US economy.

A third effect from this part of the proposed regulation will be on the asset mix of a corporate credit union's investment portfolio. This weighted average life limit will make it very difficult for a corporate credit union to invest in agency mortgage-backed securities. As mentioned above, the interest rate risk inherent in mortgage-backed securities can be somewhat offset through the use of derivatives. One might argue that this WAL test gives a clearer picture of an institution's liquidity of its investment portfolio relative to its liabilities. However, agency MBS are highly liquid instruments that can be easily sold if liquidity is needed. Unlike non-agency MBS, agency pass-through securities have no credit risk and pose very little risk to a widening of credit spreads. There are very active and liquid markets for borrowing using agency MBS as collateral should liquidity needs arise.

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Section:

704.8 (h) – Weighted average asset life (page 182) – continued

Impact *continued*:

Agency MBS, used properly, are a prudent investment alternative for corporate credit unions. This restriction will preclude the use of such instruments and will reduce the yield potential on a corporate credit union's portfolio, thus lowering available rates on corporate credit union certificates.

We recommend:

You propose that loans be excluded from the calculation of weighted average life of the investment portfolio. Additionally, we urge you to recommend a longer restriction on weighted average life of 3 years and that Agency and government-guaranteed securities be treated separately with a longer weighted average life restriction of 5 years.

Section:

704.6 – Credit risk management

(d) Sector concentration limits (page 177)

(1) A corporate credit union must establish sector limits that do not exceed the following maximums:

(3) A corporate credit union will limit its aggregate holdings in any investments not described in paragraphs (d)(1) or (d)(2) to the lower of 100 percent of capital or 5 percent of assets. The NCUA may approve a higher percentage in appropriate cases.

(4) The following investments are also excluded from the concentration limits in paragraphs (d)(1), (d)(2), and (d)(3): Investments in other federally insured credit unions, deposits in other depository institutions, and investment repurchase agreements.

Analysis:

Federal funds transactions are used to invest short-term liquidity. This is particularly important given the inter-month cash variability a corporate credit union typically experiences.

Federal funds transactions are not specifically excluded from the sector concentration limits, so paragraph (3) takes effect limiting aggregate federal funds transactions to the lower of 100 percent of capital or 5 percent of assets. This limit would severely limit a corporate's access to the federal funds market.

Paragraph (4) allows for an exemption to the concentration limit rules for deposits in other depository institutions but not specifically for federal funds transactions. Although Fed Funds transactions are nearly identical in practice to large wholesale deposits, they are considered sales and are not included in this exemption.

Impact:

Corporates will have difficulty investing ample short-term liquidity at reasonable rates. They may also have to reduce the rate they are paying to their member credit unions on their overnight accounts.

We recommend:

That you urge the NCUA to change the definition of deposits to include Federal Funds or to change Section 704.6 (d) (4) to include Federal Funds transactions sold to other depository institutions in the exemption from concentration limits.

Section:

704.6(c) – Issuer concentration limits (page 176)

(1) General rule. The aggregate of all investments in any single obligor is limited to 25 percent of capital or \$5 million, whichever is greater.

Analysis:

Federal Funds transactions are used to invest short-term liquidity. This is particularly important given the inter-month cash variability a corporate typically experiences.

The limit on aggregate Federal Funds sales to a single obligor is 25% of capital. There are a limited amount of counterparties that are bidding for Federal Funds at any one time in the marketplace. This limit is too small given the limited amount of counterparties bidding and will cause difficulty in managing a corporate's short-term liquidity position.

Impact:

Corporates may have difficulty investing short-term liquidity at reasonable rates. They may have to reduce the rate they are paying to member credit unions on their overnight accounts.

We recommend:

That you urge the NCUA to change Section 704.6 (c) to allow a larger single obligor limit of 200% of capital on money market transactions with a term of 90-days or less. An alternative solution would be to specifically allow a single obligor limit of 200% of capital for Federal Funds transactions sold to other depository institutions.

Section:

Part III Expanded Authority – Derivatives

(b) Credit Ratings:

(1) All derivative transactions are subject to the following requirements:

(i) If the counterparty is domestic, the counterparty rating must be no lower than the minimum permissible rating for comparable term permissible investments; and

704.8 Asset and liability management

(ii) If the counterparty is foreign, the corporate must have Part II expanded authority and the counterparty rating must be no lower than the minimum permissible rating for a comparable term investment under Part II Authority.

704.6 – Credit Risk Management

(f) Credit Ratings (page 178)

(2) At the time of purchase, investments with long-term ratings must be rated no lower than AA– (or equivalent) by every NRSRO that provides a publicly available long-term rating on that investment...

Analysis:

Credit risk on derivatives used in the manner described in the current and proposed regulations is much less risky than in investments. Derivative contracts are not investments. Yet the proposed regulation holds derivatives to the same standard as investments.

Master ISDA agreements are in place with each derivative counterparty, which allows for netting of exposures and requires collateralization of mark-to-market exposures beyond a predetermined threshold. This significantly limits the credit exposure on a derivative to the threshold amount, which is a small amount and in many cases near zero.

Derivatives are typically executed with major commercial or investment banks. By holding derivatives to the same standards as investments, we will be restricted to using counterparties that are rated AA- or better. Currently there is just one counterparty that has a rating of AA- or better. The proposed regulation would severely restrict a corporate from executing derivatives due to a lack of counterparties.

Impact:

Corporates would lose the ability to execute derivatives, which would limit their ability to manage interest rate risk. It would also limit the corporates' ability to issue structure products such as floating, callable, step-up or amortizing certificates.

Credit unions would lose an attractive higher-yielding investment vehicle that would compete with Agency securities.

Furthermore, corporates would not be able to provide a hedge program to member credit unions.

continued...

Section:

***704.6 (f) Credit Ratings -
continued***

Impact *continued*:

The long-term liquidity options for credit unions would be diminished because corporates would have to limit the term loans they offer to members.

We recommend:

That you urge the NCUA to exclude derivatives from the investment credit ratings and concentration limits. We also urge you to comment on creating a separate limit of 5% of capital as the maximum exposure threshold amount allowed to be negotiated in the Master ISDA agreements with counterparts.

Section:

704.19 – Disclosure of executive and director compensation (page 187)

(a) Annual disclosure.

Corporate credit unions must annually prepare and maintain a disclosure of the compensation, in dollar terms, of each senior executive officer and director.

Analysis:

This section requires that corporates provide to their members certain information about the compensation and benefits of senior executive officers and directors.

Section 704.2 defines a *senior management employee* as: [A] chief executive officer, any assistant chief executive officer (e.g., any assistant president, any vice president or any assistant treasurer/manager), and the chief financial officer (controller). This term also includes employees of any entity hired to perform the functions described above.

In the currently proposed regulation, the definition of “senior management” is too encompassing and broad – far more than what is required of publicly-traded companies governed by the SEC.

Impact:

A corporate credit union may experience difficulty recruiting mid-level executive positions based on its inability to keep salary data confidential.

We recommend:

The definition of “Senior Management Employee” should be changed to include only the top wage earners of the corporate (similar to the SEC rule II.C.6.a). The definition would include the President and CEO, the principal financial officer and the three most highly compensated executive officers.

We are not recommending any changes to the definition of compensation.

Section:

704.8 – Asset and liability management

(k) Overall limit on business generated from individual credit unions (page 183)

On or after [INSERT DATE 30 MONTHS AFTER DATE OF PUBLICATION OF FINAL RULE IN THE FEDERAL REGISTER], a corporate credit union is prohibited from accepting from a member or other entity any investment, including shares, loans, PCC, or NCAs if, following that investment, the aggregate of all investments from that member or entity in the corporate would exceed 10 percent of the corporate credit union's moving daily average net assets.

Analysis:

This regulation makes sense from a prudent liquidity management standpoint and WesCorp agrees that a limit should be in place on the aggregate investment credit unions place in a corporate. The 10% limit seems reasonable.

Where we have issues with the regulation is in dealing with the short-term liquidity volatility a corporate experiences inter-month. A typical corporate's balance sheet can fluctuate upwards of 25 percent of assets within a month. This may require a corporate to obtain inter-month funding in order to avoid liquidating its portfolio into adverse market conditions. Typical large lenders include the Federal Reserve Bank, the Federal Home Loan Bank, Repurchase Agreement counterparts or Federal Funds counterparts.

Impact:

The current limit of 10% may force a corporate into short-term borrowings with less favorable terms regarding price, maturity and collateral. It may also be damaging to the corporate's earnings: It would force corporates to maintain larger cash balances, which would likely be detrimental to earnings.

The proposal may limit a corporate's ability to offer reasonably priced short-term liquidity solutions for its members.

continued...

Section:

704.8 (k) Overall limit on business generated from individual credit unions (page 183) – continued

We recommend:

We urge you to comment on allowing borrowings with a maturity of 30 days or less, from either the Federal Reserve Bank, a Federal Home Loan Bank, a Repurchase Agreement counterpart or a Federal Funds counterpart in excess of 10% of the corporate credit union’s moving daily average net assets by eliminating the “or other entity” part of the regulation.

As an alternate approach, you could urge the NCUA to allow a higher borrowing limit of as much as 20% of the corporate credit union’s moving daily average net assets from the previously mentioned entities.

Section:

***704.11 Corporate Credit
Union Service Organizations
(Corporate CUSOs)***

***(e). Permissible activities
(page 185)***

A corporate CUSO must agree to limit its activities to:

- (1) Brokerage services,**
- (2) Investment advisory services,**
and
- (3) Other categories of services as approved in writing by NCUA and published on NCUA's website.**

Analysis:

Regarding (e)(3) (*“Other categories of services as approved in writing by NCUA and published on NCUA’s website.”*) Permissible activities under this section are completely nonexistent and undefined. Additionally, it is unclear which current Corporate CUSOs would be allowed.

Impact:

Credit unions will lose a competitive advantage in the marketplace if Corporate CUSOs have limited ability to invest in and/or offer services that will enhance their abilities as financial institutions. Such ambiguity in the regulation will lead to credit unions looking outside the credit union system for solutions that could and should be offered by Corporate CUSOs.

We recommend:

We urge you to seek and ask for clarity with regard to what will actually be permissible in the final rule.

Closing remarks

There is no question that the NCUA put a great amount of effort and thought into this proposed regulation. However, it is not viable in its current form. If it is permitted to be enacted as drafted, it will make it virtually impossible for corporate credit unions to operate in any kind of viable manner.

For America's credit unions, it means:

- Fewer competitive investing options
- Lower yields on corporate deposits
- Limited long- and short-term liquidity options
- No credit union-offered hedging programs
- Fewer credit union-owned, competitive service solutions

What can you do?

Consider what this rule means for you and your credit union, directly and through the viability of a member-owned aggregating financial institution, a corporate.

Then write a letter to the NCUA before March 9, 2010. Get them to change the rule.

Additional resources

To help you think further about this, we have organized a series of Town Hall meetings, in which you can take the opportunity to discuss the Proposed Rule with WesCorp.

For more information, visit

<http://quest.cvent.com/i.aspx?5S%2cM3%2ccb6505afb2a5-4b28-831a-804761a2f2b0>

There is also a special NCUA Proposed Rule resource page on our Member Center. Here you'll find a template comment letter that you may either copy completely or take selected sections and send to the NCUA from your credit union.