

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

RE: Advanced Notice of Proposed Rule Making
Corporate Credit Unions

Dear Ms. Rupp

The New Jersey credit union movement consists of approximately 215 credit unions with \$10.2 billion in assets and more than 1.1 million members. The New Jersey Credit Union league's affiliated credit unions represent more than 85% of the state's total credit union assets and total credit union members.

The majority of our credit unions settle through Members United Corporate (as a result of the merger of the former New Jersey-based Garden State Central Corporate). A smaller number settles through the Pennsylvania-based Mid-Atlantic Corporate. Many of our larger members have membership in more than one corporate.

Despite the recent news, our credit unions remain supportive of their corporates. A survey of our members taken after January 29, 2009 shows that 96% of respondents would like to see a corporate credit union system in the future.

The corporates are important to most credit unions and are integral to their operations. In many instances, member credit unions look to their corporate for services other than settlement. From liquidity and investments to consultation and new product ideas, our credit unions find value in what the current corporate system offers. As a small credit union state, many of our members would be detrimentally impacted if they did not have a corporate on which to rely for settlement, payments, liquidity and investing.

The corporate system as currently structured requires changes that reflect the reality that our own member credit unions face: businesses that don't provide value will not survive. The existing two-tiered system has artificially maintained a network that is inefficient. Any future corporate system must address long term profitability and value, and as part of that, consolidation.

With an average of 11.80% net worth, our credit unions remain well capitalized. However, they are not immune from the current economic cycle. In addition to seeing loan losses and decreased business resulting from layoffs and a general slowing of the State's economy, we are also in direct competition with large New York money center banks that received several injections of government funding. These two situations require our credit unions to maintain a solid capital position.

Some might say that with our solid capital position our credit unions can afford to recapitalize the NCUSIF. However, many of our members would prefer to see a solution that protects their members' hard-earned capital. It is appropriate to note that in the credit union business model capital comes to the system from one source only, retained earnings. Therefore, it is essential to preserve our equity position for any potential unforeseen losses but especially for future growth.

We offer the following responses to your request for comment on the ANPR.

Liquidity and Settlement

Corporate Credit Unions (CCU's) act as the primary providers of both liquidity and settlement for our member natural person credit unions (NPCU's). The cash management functions must remain as core components of any restructured corporate system.

Relative to liquidity, NPCU's need to have the ability to utilize their corporates for liquidity purposes. Many of our members maintain emergency lines of credit with their corporates for their unplanned liquidity needs. Corporate credit unions know their member credit unions well and often are in the best situation to structure borrowings for them.

Even though many CCU's have established multiple funding alternatives, it would seem prudent that they be provided with an additional source of liquidity that is less susceptible to market fluctuations. Both the Federal Reserve and Federal Home Loan Bank Systems have access to additional liquidity resources. A similar solution must be developed for the Corporate System.

Perhaps elimination of the prohibition against CCU's directly accessing the Central Liquidity Facility (CLF) would be the easiest way of providing such a resource. Development of an "Office of Finance" much like the Federal Home Loan Bank System may be another alternative. However, any open market activity like this would need the support and cross collateralization of all the CCU's, thereby strengthening any debt offering and enhancing the liquidity opportunities for the system.

Prudent regulatory guidelines that monitor liquidity ought to be enhanced and more dynamic modeling requirements should be implemented.

Relative to settlement, our member credit unions rely on the corporates to act as the gateway into the payments and settlements systems. Oftentimes corporates provide an affordable solution for credit unions. This is especially true for smaller credit unions that do not have the resources to establish relationships with the Federal Reserve or the Federal Home Loan Banks. As such, this resource must be provided in any future redesign of the system.

The current system is not without its weaknesses and these should be addressed. There is significant redundancy in the system relative to infrastructure and expense load. Greater

value could be generated for our member credit unions if consolidation of the system were to occur.

Carving out the payments systems to reside in a CUSO may be an appropriate means of establishing cooperation amongst the myriad of payment systems in the CCU network.

Because return on investment will be so important in any new system, it is important that any future CUSO based system be permitted to create and use “excess capacity” to serve “non-credit union” entities, such as banks or other financial institutions. Such an action would drive scale, lower costs and ultimately create greater profit for NPCU’s.

Regardless of the solution selected, the practice of setting aside funding for settlement must be required. It is of concern that had the NCUA not stepped in to fund US Central, our members' settlements were at risk of rejection.

Structure

New Jersey credit unions have a unique perspective of the structure of the corporate system. It is not simply that our membership is served primarily by two corporates, but more so that we have seen consolidation first hand and, until the recent market dislocation, benefited from an increasingly larger corporate.

When New Jersey’s former corporate, the Garden State Central Corporate, merged with the former New York-based Empire Corporate, our credit unions received significant benefits. From greater returns to a more diversified product line, significant value was created from the merger. When Empire Corporate merged with Illinois-based Mid-States Corporate to create Members United Corporate, our member credit unions saw similar creation of value, this time through scale, expertise and more specialized products and services. In fact, what is now Members United is the product of 7 corporate CU mergers. Members United is also unique in that it completed the first merger of noncontiguous corporates with the combination of then Empire Corporate and South Dakota Corporate. With Check 21 and the overall proliferation of technology, it has become easier for corporates to operate across state lines.

Having had this experience, we recognize that consolidation is appropriate and at times, necessary. In a highly competitive environment where products have been commoditized, scale to drive profit is critical. That appears to be the case in our corporate system.

We support a model that eliminates one tier of the two-tier corporate system and that provides for significant consolidation of the remaining corporates into regional areas. Ideally, having as few of these regions as logistically feasible would provide greater scale and profit. Any future solution ought to take into account a credit union's natural tendency to want to do business with people they know.

In such a regional environment, NPCU membership for “core services” (see below) would follow guidelines similar to what is found in the Federal Reserve and Federal

Home Loan Bank Systems. Membership and respective capital would be assigned by geographic location. However, unlike these systems, provision should be made for portability of membership so that NPCU's have the ability to change CCU's if they are dissatisfied with the service.

Certain limitations should apply to what we deem as "core services" funded by a core capital requirement. These services are limited to payment/settlement, term loans, and short term cash investments (i.e. less than 270 days or equal to repo standards).

To limit competition, fields of membership would be restricted to a geographic region of the country. Further, an NPCU may belong to only one CCU at a time for core services. Provision for portability of membership must be made as should be provisions to prevent significant impact on CCU capital if multiple NPCU's wish to leave.

Natural person credit unions should be afforded the ability to utilize any CCU for other non-core services further defined under the capital section of this letter. Corporate credit unions should be allowed to develop other "non-core" or "alternative" products for sale to NPCU's as fits with their business plan and strategic direction. These products would be provided through the NPCU's primary CCU as a brokered service.

CUSO's

Additional opportunities should be afforded to system participants for brokered CUSO services across regional providers. This will be solely based on the regional's ability to work cooperatively and negotiate with each other (i.e. Simpli CD).

Entry into this "alternative" market would require a commitment of what we like to define as the "preferred capital structure" of the regionals. The portability of preferred capital should be a negotiated by each regional CCU.

In this scenario, there are in essence two types of business CUSOs. The first is funded by the core capital of the system. It provides basic essential payment and settlement services to the financial service industry. The stable nature of the business may also be cross collateralized with a pledge of NPCU capital (not a payment) to enhance the opportunity for open market activities of the core system.

The second type of CUSO is solely based upon the discretion of the regional's ability to raise capital for investment in other non-core business activities. (see attached chart) If a region recognizes there is demand for specific products and services they will have the ability to solicit their membership and other regional's for investment. This two-tier capital structure is typically called "pay-to-play". Investors understand the risk of such business ventures and recognize that additional investment of preferred capital is needed to fund operations. This is typical of FHLB participants that use the system for advances. They are asked to contribute additional capital related to the scope of their borrowings.

Capital and ROI

Capital is the foundation of any business. In the current system, capital levels are used to support settlement services, inherent business risk and all business ventures of the corporate. A primary focus of the ANPR is to separate payment/settlement services from investments and other business products. However, it should be noted that settlement services require short-term cash funding and investment as part of the basic core product needs.

We propose that the future corporate system capital structure consist of three forms of capital based on NPCU participation and the business strategies of a regional corporate as defined by their board of directors. These forms are defined as “Core,” “Preferred” and “Pledged” and are defined below.

Core Capital – This represents a NPCU’s permanent investment in the corporate credit union system allowing the credit union to utilize the services of the payment systems environment through a regional provider. Any dividends or patronage rebates are paid to the core participants through the regional CCU. The following are examples of core services:

- Payment check settlement and clearing services
- Fedwire and ACH services
- Coin and currency
- Treasury/Money desk activities
 - Short term cash settlement
 - Investments
 - Advances

Preferred Capital – This represents an additional investment of permanent capital by an NPCU that would be required for the utilization of alternative services that may be offered by the CCU that are outside of the core. These programs may vary from region to region based on an institution’s resources, scope and needs of their membership.

Determination of levels of “preferred” capital should be made on a risk-weighted basis to allow the participating CUs more flexibility in managing and reserving for the inherent risk of such activities. Any dividends paid will be related to the performance of the product and related regional corporate. These services may include the following:

- Long term liquidity advances
- Investment and portfolio management services
- Asset liability management services
- CD brokerage or SimpliCD participation
- Loan participation services
- Member business loan underwriting
- Other CUSO ventures deemed profitable by the regional CCU and within the acceptable scope of activities defined by NCUA.

Pledged Capital Guarantee – We recognize that additional capital will probably be required to ensure the viability of the new CCU system. Further, that NPCUs may be asked to pledge a portion of their excess capital to guarantee the core system operation. This being likely, we feel it would be prudent for some provision that allows NPCU's to retain ownership of their capital and pledge those funds only if needed in the event of a loss or default of the core system.

The guarantee constituted by this pledged tier of capital would represent an additional cross collateralization layer of the core payment systems CUSO in two parts. First the pledge could also be used to offset immediate liability charges associated with previous investment activities.

Further, it allows NCUA to periodically evaluate the value of the investment in question. Based on those values CUs can make an off balance sheet pledge of their capital directly related to the anticipated liability. Therefore CUs would not show a loss on their income statement for an event that may have a lesser impact over time as these assets are given time to recover.

The option to pledge a percentage of their capital for the portion of “unknown” future expenses associated with the variability of the investment liability would better enable credit unions to grow their business. A loss would only be recognized once realized by NCUA.

The second part would come into effect once the liability is remedied over time the pledge can further be utilized to enhance open market activities which include the issuance of debt to the free markets. This assumes that credit agencies would view this pledge as a “credit enhancement” of core capital levels.

The CCU system would issue debt in the open market to supplement system liquidity needs. NCUA would periodically evaluate the need of the guarantee and either expand or contract the requirement as needed based on the performance of the core system. The guarantee will not be used for non-core business operations. The guarantee may constitute a restructuring of a CU's current capital structure. However we feel it is best treated as a segmented portion of a CU's current capital position defined under GAAP as an off balance sheet commitment (No further impact on a NPCU's income statement, unless a true loss is incurred).

Credit unions need to consider if TARP is not available to the credit union industry then the NPCU guarantee will be needed to further enhance the credit worthiness of the new CCU system, allowing for expanded rating opportunities, which in turn should relate to cheaper liquidity sources for CUs.

Investments

For any future system to be successful it must generate enough profit to pay attractive dividends to its NPCU's while building capital. If the system is stripped of any profit making potential that exists in managing its balance sheets with various investment

vehicles (for example, derivatives or rate swaps), it is unlikely that it will be able to survive in a form that will be useful to its member NPCU's in the long term.

Obviously there are risks in the current system that must be addressed so that a repeat of concentration and losses do not occur. However, allowing corporates to have access to various "approved" investment securities may be an appropriate component of any restructure, provided that expertise and regulatory oversight exists.

It is of concern that any future restructure of permissible investments may overly limit CCU's out of a reaction to the current level of losses seen in the system. Such an action runs the risk of eliminating profit opportunity that would prevent the CCU's ability to both mitigate risk and grow capital. It is urged that a balance be struck between the system's need for CCU's to deliver profit while managing risk. We therefore propose that a more stringent series of testing, modeling and, where appropriate, limits on concentration, investment types and terms be imposed. Additionally, that clarification be provided on the use of ratings agencies. It would seem that an over reliance on their ratings may have contributed to the current loss situation.

We recognize that in the future there may be new types of investments that are developed that may enhance a CCU's ability to manage risks and deliver profit. We therefore propose that some mechanism be established that would allow for application for regulatory approval of new investment vehicles as they become available.

Lastly we recognize that CCU's have been able to utilize expanded authorities to benefit NPCU's, either through the facilitation of loan participations or derivatives. We would suggest therefore that some application for and granting of "expanded authorities" should continue provided that risk mitigation programs are in place, expertise has been demonstrated and a clear business need has been shown to exist.

Governance

Governance issues should be left up to the individual regional CCU or governing body. However, volunteer compensation should not be allowed. If the use of outside experts is incorporated into a final governance structure, payment of these individuals may be necessary to facilitate their participation and payment should be within professional standards.

Educational requirements for volunteers ought to be made more uniform and be specific to risks being taken on by the corporate. Further, training for specific areas should be mandatory for anyone holding a volunteer position. NCUA should mandate standard testing of those that retain a board or committee appointment where specific expertise is required. Failure to pass the standards would disqualify such individuals from serving in a specific capacity.

The use of outside experts in an advisory capacity or as members of the supervisory committee may have merit. Evaluation of supervisory committee oversight of CUSO activities may also be worth evaluating. Transparency of financial reporting ought to be

made more uniform and include any identified risk areas (ie: investment types and concentrations).

Regulatory

Provision must be made for regulatory review and approval of new investment vehicles. Further that application for and granting of "expanded authorities" should continue provided that risk mitigation programs are in place, expertise has been demonstrated and a clear business need has been shown to exist.

Corporates are complicated businesses and require some specialty in understanding and regulating them. Therefore growing the competency level of examiners around the corporate system must be continued and enhanced.

Final Comments

We appreciate NCUA allowing us to comment on this critical ANPR. We believe the restructuring of the corporate credit union network is the most significant development in the credit union movement since passage of the Credit Union Membership Access Act. In fact, how NCUA handles the corporate restructuring will have long-term impacts for the entire credit union movement for years to come.

New Jersey credit unions want and need a strong corporate credit union network. In summary, we believe NCUA should look at the benefits of significant corporate network consolidation and the creation of a regional-based corporate network tied together by a CUSO structure for payment systems.

We feel strongly that competition among corporates for core services should be dramatically reduced in this new network. Clearly, ensuring that the new corporate network is sufficiently capitalized is critical to success. We believe credit unions should capitalize corporates based on their usage. Credit unions that wish to utilize a corporate for noncore corporate products should have an additional capital commitment than those credit unions that choose core corporate services only. That structure does not exist today.

We encourage NCUA not to overreact to the current market dislocation by severely restricting corporates' investment authorities. If corporates were to become too limited in their investment activities, it would hurt their ability to deliver a competitive return to the marketplace, and thus marginalize their overall value to the credit union movement. NCUA should however consider future concentration limits in the investment portfolio. NCUA should continually seek out ways to enhance regulation of the corporate network, and implement best practice risk management and modeling.

Creating a new corporate system will take time, diligence and some very difficult decisions, but the benefits of a more efficient corporate network that delivers products and services based on the committed capital of its credit union owners will only further the success of the entire credit union movement.

Please do not hesitate to contact the New Jersey Credit Union League for further details or any questions relating to our ANPR response.

On Behalf Of New Jersey Credit Union League,
Shawn Gilfedder
Chairman

Open Market Payment Systems Model

