September 25, 2006

Mary Rupp
Secretary of the Board
National Credit Union Association
1776 Duke Street
Alexandria, VA 22314

Dear Members of the Board:

Thank you for the opportunity to comment on the Proposed Rule – Part 703 regarding Permissible Investments for Federal Credit Unions (FCUs). We believe the NCUA Board's approval to permit FCUs to invest in repurchase transactions in which the instrument consists of whole loan mortgage collateral is a positive and prudent development which will benefit the members. It is our opinion that the new permissible investment guideline will enable FCUs to improve their portfolio returns within the context of a diminutive risk profile.

The purpose of our comment letter is to provide some suggestions to the proposed rule based on our actual working knowledge of the whole loan repurchase market. We believe the final proposed rule should ameliorate all possible risks for FCUs inside the framework of industry standard practices and operational procedures. If the final amendment contains restrictions or operational procedures beyond what the marketplace participants are accustom to, FCUs will not find any counterparties to transact with.

Roundstone Advisors, LLC is a registered investment advisor and independent third party securities lending agent specializing in fixed income instruments. We currently provide securities lending services and asset management to FCUs with combined assets in excess of $5 billion and have extensive knowledge of the securities lending and repurchase financing markets.

The whole loan repurchase marketplace is a multi-billion dollar investment activity whose participants include pension funds, money market funds, major banks and broker dealers. These institutional investors and counterparties frequently transact on a daily basis using industry standard documentation which has resulted in the development of a ubiquitous market.

While the whole loan repurchase market maturation over the past few years has streamlined operational procedures and reduced systemic risk, there are several risks

associated whole loan repurchase agreements that should be seriously considered prior to investment.

The most important issue for a FCU (or any investor) is the return of principal upon the maturity of the repurchase transaction. There are two risk control requirements when implemented which would statistically eliminate the event of default or insolvency.

The first risk management issue is the term of the repurchase agreement. A shorter maturity dramatically reduces counterparty bankruptcy/insolvency risk. Approximately 90% of the whole loan repurchase market has maturities within 30 days and a majority of these are on an overnight basis. Such extremely short timelines diminish the FCUs counterparty credit exposure.

The credit worthiness of the repurchase agreement counterparty is the other important risk management decision in the transaction. Repurchase agreements are the general obligation of the issuer. If the issuer is solvent then the collateral backing the repurchase agreement is irrelevant. There are a few meaningful credit metrics which may be applied to determine a credit worthy counterparty.

Never has a Primary Government Securities Dealer become insolvent on a short-term basis. In an effort to protect credit unions from unnecessary credit exposure our recommendation would be to limit whole loan repurchase agreement counterparties to the twenty-three (23) Primary Government Securities Dealers. Counterparties must be U. S. Treasury approved Primary Government Securities Dealers authorized to buy and sell government securities in direct dealings with the Federal Reserve Bank of New York in its execution of Federal Open Market Operations. Such dealers are qualified by the Federal Reserve in terms of reputation, capacity, capital requirements, and adequacy of staff and facilities. If the credit worthiness of Primary Dealers as counterparties is suitable for the United States Federal Reserve it may also be adequate for Federal Credit Unions.

Alternatively, the proposed rule could require counterparties to have a Standard &Poor's or similar agency short-term rating of A-1. Once again, there is no historical precedent of an A-1 rated counterparty becoming insolvent overnight.

The two straightforward risk controls of short maturity and a credit worthy counterparty combine to protect the FCUs well beyond other permissible investments. It will be extremely detrimental if the final rule maintains the current counterparty concentration limits. The first-lien mortgage notes requirement in conjunction with the use of a tri-party custodian has already limited potential counterparties. The concentration limit of 25% per counter party and 100% overall does not improve the risk profile of the whole loan agreement when using a credit worthy counterparty for an overnight transaction already

eliminates all observed risk. This concentration limit will be detrimental to the members and reduce the usability of the new investment vehicle.

In addition, the standard Master Repurchase Agreement issued by the Bond Market Association in combination with a generic Custodial Tri-party Agreement further protects FCUs by defining the process of collateralization as well as the methods and procedures for restitution in the event of insolvency.

The role of the tri-party custodian is instrumental in the whole loan process. The custodial banks take several measures to protect both the lender and the borrower. As defined in a generic tri-party agreement custodial "banks shall be responsible for verifying all Purchased Securities are Securities" (Section 3, Specific Repurchase Transactions). Further, each custodial bank is required to provide details of the whole loans securitizing each transaction:

"Bank shall send to Buyer and Seller a statement describing the purchased Securities held in a Buyer's account as of the close of each Business Day. That statement shall be sent by the close of the Business Day following the date to which such statement applies. The statement shall include the Market Value of such purchased securities as of the date to which the statement applies. Buyer and Seller shall promptly review all such statements and shall promptly advise Bank of any error, omission, or inaccuracy in the Purchased Securities position." – Section 6: Daily Statement to Seller and Buyer

In addition to providing trade and security detail the custodial also serves as an intermediary between the buyer (Federal Credit Union) and seller (Broker Dealer). Specifically, "the bank shall be a "securities intermediary" and ensure that "all property in Buyer's and Seller's account, other than cash, shall be a financial asset and investment property as such terms are defined in revised Article 8 and 9 of the Uniform Commercial Code as the same may be in effect pursuant to applicable law or regulation" (Section 2: Maintenance of Accounts, Generic Tri-party Agreement). The above reference is extremely important as it provides protection to the Buyer under Federal Bankruptcy Laws in the event a counterparty was to become insolvent as repurchase agreements are classified as securities.

The classification of repurchase agreements as securities would enable the Buyers of whole loan repurchase agreements to pursue the swift sale of collateral in the event their principal investment could not be recouped. It is our understanding that bankruptcy laws specifically allow the netting (selling of collateral) without intervention of the bankruptcy court because repurchase agreements are Qualifying Financial Contracts (QFC) which are exempt under bankruptcy statues. The following link is to an FDIC opinion discussing the latest bankruptcy laws and their application, specifically as it relates to repurchase agreements *(http://www.fdic.gov/bank/analytical/fyi/2005/101105fyi.html).*

In addition to the information presented above regarding the whole loan repurchase agreement definition and custodial responsibilities, recent legal developments have strengthened the safety of the whole loan transaction discussed. A majority of Whole Loan Programs in combination with their program's custodian have implemented refined legal parameters to protect their investors. Additions have been made to tri-party repurchase agreements to provide buyer's with a "perfected security interest" in the whole loan collateral. This slight modification provides priority to holders of the collateral in the event of a default, placing them in front of other creditors in bankruptcy proceedings.

Finally, as an added measure purchasers of whole loan repurchase agreements (Buyers) are protected through over-collateralization. Industry standard documentation permits whole loan repurchase agreements to be collateralized upwards of 105%. This guideline provides a cushion of 5% in the value of collateral to protect the investor from any whole loan defaults.

All of the safeguards highlighted above have combined to make whole loan repurchase agreements a prudent investment choice. The purpose of our correspondence is to provide written support for the authorization of the purchase of whole loan repurchase agreements and highlight the risk controls associated with such a transaction. Hopefully, we have been able to offer broad suggestions as well as provide details on the current market environment and industry standards.

Roundstone Advisors is fully supportive of whole loan repurchase agreements and their suitability for the FCU investment guidelines. Authorizing repurchase agreements collateralized by whole loans would provide incremental income to dozens if not hundreds of FCUs which they could pass along to their members.

Please contact us with any comments or questions and we eagerly await the final rule.

Kinds Regards,

Sean McNamara
Managing Director & Founder
Roundstone Advisors, LLC