September 25, 2006

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

Dear Members of the Board:

Thank you for the opportunity to submit additional comments with respect to the proposed rule on permissible investments. We have had an opportunity to meet with NCUA Staff regarding the proposed conditions placed on the proposed investment activity and ask your consideration of additional information and suggestions.

Specifically, we would like to address:

- the risk profile of repurchase agreements using whole loan collateral;
- criteria that could allow credit unions to participate at a higher level than proposed; and
- potential for third-party aggregation of securities from multiple credit unions to form an investment pool.

Risk profile

The proposed regulation limits participation in whole loan repurchase agreements to 25% of net worth for a single counterparty and 100% of net worth overall. We continue to believe this limit is too restrictive. We understand this percentage was drawn from OCC Regulations limiting bank participation in somewhat similar types of investments. We do not believe that bank investments are a comparable investment guideline for credit unions inasmuch as bank investment activity constitutes a much broader range of overall risk. As you know, credit unions remain limited in their investment authority to conservative options comprised primarily of government obligations and their derivatives.

In terms of investment risk, we were advised that Staff's concern lay in the potential bankruptcy of the counterparty. We do not believe that under the short term of this investment activity counter-party risk of bankruptcy presents a realistic concern. The counterparties engaged in whole loan repurchase agreements are brokers such as Bear Stearns, Merrill Lynch and Lehman Brothers. It is highly unlikely that the Market would not have forewarning of a potential failure of any of these firms within the 90-day term of these types of transactions. This is especially true in light of the required short-term rating of A-1 or better.

Moreover, under the Bankruptcy Act of 2005, significant safe harbor protections are provided to parties of whole loan repurchase contracts. Under these protections, whole loans are specifically exempt from being included in a counterparty bankruptcy. The party on the investment side of the transaction may

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liquidate the collateral immediately upon the failure of the counterparty to repurchase the collateral. We are enclosing a legal opinion from the law firm of Moore, Brewer, Jones & Tyler specific to this issue.

As we have commented in the past, there is a multi billion dollar market for whole loans; therefore, liquidation in the unlikely and unrealistic event of a counterparty bankruptcy would be swift. We are also enclosing a memorandum from ASTEC Consulting that speaks specifically to the breadth of the market for whole loans.

The proposed regulation also requires a long-term counterparty rating of no lower than A- or its equivalent. After discussions with Staff, we can understand their view that this may have a mitigating impact on perceived counter-party risk. Although we continue to believe that the long-term rating requirement is unnecessary from a practical standpoint, we do not see this additional rating requirement as a barrier to the efficacy of the proposed rule.

Options for criteria to permit higher level participation

We continue to strongly believe that current NCUA regulations on repurchase agreements, taken in their entirety, provide adequate controls and guidelines for safety and soundness with respect to this activity. We also believe that with the protections offered under the Bankruptcy Act of 2005, together with the rating requirements proposed, there is more than adequate risk mitigation built in to the proposed rule.

However, in the interest of presenting a constructive alternative to the proposed 25% limit on individual counterparties and 100% overall, a stronger correlation between the term of the agreement and associated limits would seem a practical option. Specifically:

Overnight transactions: No limitations, either by counterparty or overall. Inasmuch as these transactions roll off at the opening of business on the first day following the start of the agreement, there is no measurable counterparty risk.

Two through 10 business days: No more than 100% of net worth for a single counterparty, no overall limitation. Even in a hypothetical worst case scenario, with collateralization at 104% (which is standard for these types of transactions), the risk exposure to a credit union, and ultimately the Share Insurance Fund, would be nominal.

Eleven through 45 business days: No more than 50% of net worth for a single counterparty, no overall limitation.

Forty-six through 90 business days: No more than 25% of net worth for a single counterparty. No overall limitation.

To summarize, we believe these progressive levels of participation are unnecessary, but if implemented would present guidelines that could mitigate any risk to the credit union or Share Insurance Fund and still provide revenue potential for credit unions participating in this market.

Whole loan repurchase agreeement investment pools

From a practical standpoint, it takes a relatively large securities portfolio to participate in the whole loan repo market. While there are exceptions, entry into this market is currently confined to those lendable portfolios of at least $100 million or more.

A means for smaller credit unions to benefit from using whole loan repurchase agreements in a securities lending investment program would be to authorize the creation of investment pools by a third-party

securities custodian comprised of aggregated securities portfolios from a number of credit unions. We would envision an omnibus repurchase agreement where the individual legal interests in the mortgage loans are held by a third-party custodian. We believe that under this option, a 25% limit of the combined net worth of the participating federally insured credit unions would be realistic, with no overall limit to one credit union. For the purposes of this calculation, we would propose capping each individual credit union's net worth at 7%. Each credit union would hold a weighted portion of the omnibus pool and be credited earnings (or assigned losses) based on their weighted participation.

We would strongly recommend that any third-party custodian that wished to provide this service be required to first submit a proposal, contracts and guidelines to NCUA for approval.

We appreciate the opportunity to work with NCUA and its Staff on ways to better serve credit unions, protect the Share Insurance Fund, and create new investment opportunities. We are available to discuss these or other ideas at your convenience.

Sincerely,

William B. Eckhardt
President

Enclosures: Opinion from Moore, Brewer, Jones and Tyler
ASTEC Consulting White Paper on Whole Loan Market

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September 25, 2006

Norm West
Alaska USA Trust Company
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RE: Opinion addressing the ability to liquidate whole loan collateral in the event of the insolvency of a counterparty to a repurchase agreement.

Dear Mr. West:

You have requested our opinion regarding the treatment of whole loan repurchase agreements (that is, repurchase transactions where the underlying security purchased from the counter-party and subject to resale to that party is a whole loan) where the counterparty to the agreement files for bankruptcy. More specifically, you have asked whether a party to a whole loan repurchase contract can liquidate the collateral (the whole loans) immediately upon the failure of the counterparty to repurchase the collateral as a result of its filing for protection under the United States Bankruptcy Code.

We are of the opinion that the United States Bankruptcy Code, as amended by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "Bankruptcy Act of 2005;" as amended, the "Act"), provides a number of significant safe harbor protections to parties to whole loan repurchase contracts (such as Alaska USA), including permitting a party on the investment side of a whole loan repurchase contract to liquidate its collateral immediately upon the failure of the counterparty to repurchase the collateral.

In order to provide increased legal certainty in the financial markets and to take account of the evolution of the derivates markets and the rate of product development, the Bankruptcy Act of 2005 has clarified a number of existing ambiguities regarding how financial contracts will be netted and settled in an insolvency, and has additionally expanded the range of financial contracts and participants protected by its provisions. As a result, the Act now provides even greater protections and risk reduction tools for parties to repurchase agreements, making clear that, among other things, a party to a whole loan repurchase agreement is permitted to liquidate its collateral upon the insolvency of its counterparty. These protections are enumerated below.

1. The class of financial contracts protected by the Act encompasses whole loan repurchase agreements.

When the bankruptcy laws were amended in 1990, Congress attempted to exempt most types of financial contracts from the prohibitions contained in section 362 (the "automatic stay") and section 365(e)(1) (the prohibition on terminating or modifying executory contracts upon the filing of bankruptcy) to limit exposure to financial participants in the event of the bankruptcy of a counterparty. In order to dispel any uncertainty in this regard and to expand the scope of these protections, the Bankruptcy Act of 2005 includes an even broader array of financial contracts, including whole loan repurchase agreements.

Prior to the Bankruptcy Act of 2005, "repurchase agreements" were defined as agreements that provide "for the transfer of certificate of deposits, eligible bankers' acceptances or securities that are the direct obligations of, or that are fully guaranteed as to the principal or interest, by the United States" or any agency thereof with a simultaneous agreement by the transferor to transfer to the original transferor a certificate of deposit or other similar obligation either on demand or at a date certain not later than one year after the transfer. Of importance to this opinion, the Bankruptcy Act of 2005 expanded the definition to include mortgage-related securities (as defined in the Securities Exchange Act of 1934, commonly referred to as "SMMEA Securities"), mortgage loans, interests in mortgage-related securities or mortgage loans and qualified foreign government securities...."[i]

AUSA's whole loan repurchase agreements are encompassed within this broad definition and thus receive the full benefit of the protections and exemptions described below. [Note here that even if it were somehow argued that the whole loan repurchase

agreements did not fall into this broad definition of repurchase agreement, Section 555 of the Act provides the identical termination, liquidation and acceleration rights described in 3. below for repurchase agreements, with respect to "securities contracts" - an even broader definition.[ii]]

2. <u>The automatic stay does not apply to setoffs by participants in whole loan repurchase agreements</u>.

Once a bankruptcy petition is filed, an "automatic stay" generally prevents a creditor from engaging in a wide variety of actions that could affect the ownership or value of the debtor's assets (including setoffs and attempts to obtain collateral). Importantly, however, the automatic stay expressly does not operate to stay:

> (7) … the setoff by a repo participant[iii] or financial participant,[iv] of any mutual debt and claim under or in connection with repurchase agreements that constitutes the setoff of a claim against the debtor for a margin payment, as defined in section 741 or 761 of this title, or settlement payment, as defined in section 741 of this title, arising out of repurchase agreements against cash, securities, or other property held by, pledged to, under the control of, or due from such repo participant or financial participant to margin, guarantee, secure or settle repurchase agreements.

11. USCA § 362(b)(7).

Thus, a party to a whole loan repurchase agreement may enforce existing contractual right to setoff without regard to the automatic stay and other provisions of the Act that would otherwise hinder the exercise of such rights.

3. <u>The liquidation, termination and acceleration of qualifying financial contracts is expressly permitted in bankruptcy</u>.

In addition to the automatic stay of section 362 described above, upon the filing of a bankruptcy, section 365(e)(1) generally prohibits creditors from terminating or otherwise modifying executory contracts. However, under the Act, a repo participant's contractual rights to liquidation, termination and acceleration will not be stayed, avoided or otherwise limited despite the general protection afforded to debtors in section 365(e)(1) of the Act.[v]

Further, the Act now contains a section that additionally protects contractual rights to terminate, liquidate, accelerate or offset under a master netting agreement, as well as across financial contracts.[vi]

4. A receiver or conservator cannot avoid prepetition transfers of money or property in connection with a repurchase agreement.

Finally, the Act limits the trustee's avoidance powers with respect to prepetition margin payments or settlement payments made in connection with a repurchase agreement, to those made with the actual intent to hinder, delay or defraud creditors, providing as follows:

> (f) Notwithstanding sections 544, 545, 547, 548(a)(1)(B), and 548(b) of this title, the trustee may not avoid a transfer that is a margin payment, as defined in section 741 or 761 of this title, or settlement payment, as defined in section 741 of this title, made by or to a repo participant or financial participant, in connection with a repurchase agreement and that is made before the commencement of the case, except under section 548(a)(1)(A) of this title.

Thus, a party to a financial contract can realize the benefits and control its exposure even though its counterparty is on the verge of bankruptcy without worrying that the transactions occurring during the period immediately preceding a bankruptcy filing will later be undone, in the absence of actual intent to defraud.

In conclusion, a party to a whole loan repurchase agreement may liquidate, terminate and accelerate its collateral (the whole loans) immediately upon the insolvency of a counterparty and is afforded a number of additional risk management tools to protect against potential losses associated with lengthy insolvency proceedings.

I trust this responds to your inquiry, however, should you have any further questions or comments, please do not hesitate to contact me.

Yours very truly,

MOORE, BREWER, JONES & TYLER

Randy Moore

ENDNOTES

[i] Specifically, § 101(47) of the Act provides the following definition:

The term "repurchase agreement" (which definition also applies to a reverse repurchase agreement)--

(A) means--

(i) an agreement, including related terms, which provides for the transfer of one or more certificates of deposit, mortgage related securities (as defined in section 3 of the Securities Exchange Act of 1934), mortgage loans, interests in mortgage related securities or mortgage loans, eligible bankers' acceptances, qualified foreign government securities (defined as a security that is a direct obligation of, or that is fully guaranteed by, the central government of a member of the Organization for Economic Cooperation and Development), or securities that are direct obligations of, or that are fully guaranteed by, the United States or any agency of the United States against the transfer of funds by the transferee of such certificates of deposit, eligible bankers' acceptances, securities, mortgage loans, or interests, with a simultaneous agreement by such transferee to transfer to the transferor thereof certificates of deposit, eligible bankers' acceptance, securities, mortgage loans, or interests of the kind described in this clause, at a date certain not later than 1 year after such transfer or on demand, against the transfer of funds;

(ii) any combination of agreements or transactions referred to in clauses (i) and (iii);

(iii) an option to enter into an agreement or transaction referred to in clause (i) or (ii);

(iv) a master agreement that provides for an agreement or transaction referred to in clause (i), (ii), or (iii), together with all supplements to any such master agreement, without regard to whether such master agreement provides for an agreement or transaction that is not a repurchase agreement under this paragraph, except that such master agreement shall be considered to be a repurchase agreement under this paragraph only with respect to each agreement or transaction under the master agreement that is referred to in clause (i), (ii), or (iii); or

(v) any security agreement or arrangement or other credit enhancement related to any agreement or transaction referred to in clause (i), (ii), (iii), or (iv), including any guarantee or reimbursement obligation by or to a repo participant or financial participant in connection with any agreement or transaction referred to in any such clause, but not to exceed the damages in connection with any such agreement or transaction, measured in accordance with section 562 of this title; and

(B) does not include a repurchase obligation under a participation in a commercial mortgage loan.

[ii] § 741(7) defines "securities contract" as follows:

(7) "securities contract"--

(A) means--

(i) a contract for the purchase, sale, or loan of a security, a certificate of deposit, a mortgage loan or any interest in a mortgage loan, a group or index of securities, certificates of deposit, or mortgage loans or interests therein (including an interest therein or based on the value thereof), or option on any of

the foregoing, including an option to purchase or sell any such security, certificate of deposit, mortgage loan, interest, group or index, or option, and including any repurchase or reverse repurchase transaction on any such security, certificate of deposit, mortgage loan, interest, group or index, or option;

(ii) any option entered into on a national securities exchange relating to foreign currencies;

(iii) the guarantee by or to any securities clearing agency of a settlement of cash, securities, certificates of deposit, mortgage loans or interests therein, group or index of securities, or mortgage loans or interests therein (including any interest therein or based on the value thereof), or option on any of the foregoing, including an option to purchase or sell any such security, certificate of deposit, mortgage loan, interest, group or index, or option;

(iv) any margin loan;

(v) any other agreement or transaction that is similar to an agreement or transaction referred to in this subparagraph;

(vi) any combination of the agreements or transactions referred to in this subparagraph;

(vii) any option to enter into any agreement or transaction referred to in this subparagraph;

(viii) a master agreement that provides for an agreement or transaction referred to in clause (i), (ii), (iii), (iv), (v), (vi), or (vii), together with all supplements to any such master agreement, without regard to whether the master agreement provides for an agreement or transaction that is not a securities contract under this subparagraph, except that such master agreement shall be considered to be a securities contract under this subparagraph only with respect to each agreement or transaction under such master agreement that is referred to in clause (i), (ii), (iii), (iv), (v), (vi), or (vii); or

(ix) any security agreement or arrangement or other credit enhancement related to any agreement or transaction referred to in this subparagraph, including any guarantee or reimbursement obligation by or to a stockbroker, securities clearing agency, financial institution, or financial participant in connection with any agreement or transaction referred to in this subparagraph, but not to exceed the damages in connection with any such agreement or transaction, measured in accordance with section 562; and

(B) does not include any purchase, sale, or repurchase obligation under a participation in a commercial mortgage loan.

[iii] (46) The term "repo participant" means an entity that, at any time before the filing of the petition, has an outstanding repurchase agreement with the debtor.

[iv] (22A) the term "financial participant" means
(A) an entity that at the time it enters into a securities contract, commodity contract, swap agreement, repurchase agreement, or forward contract, or at the time of the date of the filing of the petition, has one or more agreements or transactions described in paragraph (1), (2), (3), (4), (5), or (6) of section 561(a) with the debtor or any other entity (other than an affiliate) of a total gross dollar value of not less than $1,000,000,000 in notional or actual principal amount outstanding on any day during the previous 15-month period, or has gross mark-to-market positions of not less than $100,000,000 (aggregated across counterparties) in one or more such agreements or transactions with the debtor or any other entity (other than an affiliate) on any day during the previous 15-month

period; or
(B) a clearing organization (as defined in section 402 of the Federal Deposit Insurance Corporation Improvement Act of 1991).

[v] Specifically, § 559 provides as follows:

559. Contractual right to liquidate, terminate, or accelerate a repurchase agreement

The exercise of a contractual right of a repo participant or financial participant to cause the liquidation, termination, or acceleration of a repurchase agreement because of a condition of the kind specified in section 365(e)(1) of this title shall not be stayed, avoided, or otherwise limited by operation of any provision of this title or by order of a court or administrative agency in any proceeding under this title, unless, where the debtor is a stockbroker or securities clearing agency, such order is authorized under the provisions of the Securities Investor Protection Act of 1970 or any statute administered by the Securities and Exchange Commission. In the event that a repo participant or financial participant liquidates one or more repurchase agreements with a debtor and under the terms of one or more such agreements has agreed to deliver assets subject to repurchase agreements to the debtor, any excess of the market prices received on liquidation of such assets (or if any such assets are not disposed of on the date of liquidation of such repurchase agreements, at the prices available at the time of liquidation of such repurchase agreements from a generally recognized source or the most recent closing bid quotation from such a source) over the sum of the stated repurchase prices and all expenses in connection with the liquidation of such repurchase agreements shall be deemed property of the estate, subject to the available rights of setoff. As used in this section, the term "contractual right" includes a right set forth in a rule or bylaw of a derivatives clearing organization (as defined in the Commodity Exchange Act), a multilateral clearing organization (as defined in the Federal Deposit Insurance Corporation Improvement Act of 1991), a national securities exchange, a national securities association, a securities clearing agency, a contract market designated under the Commodity Exchange Act, a derivatives transaction execution facility registered under the Commodity Exchange Act, or a board of trade (as defined in the Commodity Exchange Act) or in a resolution of the governing board thereof and a right, whether or not evidenced in writing, arising under common law, under law merchant or by reason of normal business practice.

[vi] (38A) The term "master netting agreement"--

(A) means an agreement providing for the exercise of rights, including rights of netting, setoff, liquidation, termination, acceleration, or close out, under or in connection with one or more contracts that are described in any one or more of paragraphs (1) through (5) of section 561(a), or any security agreement or arrangement or other credit enhancement related to one or more of the foregoing, including any guarantee or reimbursement obligation related to 1 or more of the foregoing; and

(B) if the agreement contains provisions relating to agreements or transactions that are not contracts described in paragraphs (1) through (5) of section 561(a), shall be deemed to be a master netting agreement only with respect to those agreements or transactions that are described in any one or more of paragraphs (1) through (5) of section 561(a).

(38B) The term "master netting agreement participant" means an entity that, at any time before the date of the filing of the petition, is a party to an outstanding master netting agreement with the debtor.

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Memorandum

To: Norm West
Chief Financial Officer
Alaska USA Trust Company

From: Jack Huber, Managing Director

Cc: Ed Blount, Executive Director

Date: June 17, 2004

Re: Results of Survey on Whole Loan Repo Market

You have asked us provide you with some market statistics on the depth and breadth of the whole loan repo market. Drawing on current research from our 14-year-old cooperative of securities lenders (currently over 250 institutions with $5.6 trillion in assets), and our standard practice of surveying market participants, we have compiled the information below.

While there are no official figures for the whole loan repo and cash markets, we have gathered a range of estimates from various market participants. The estimates vary depending on how one defines the whole loan product. Some participants deal only in residential mortgages, while others include commercial mortgages. According to the Bond Market Association, there was $9.2 trillion of outstanding mortgage debt in 2003, most of which is in the form of agency and private-label paper. Estimates indicate that there are approximately $1.8 trillion of residential securitized mortgages in the marketplace. The whole loan product refers to the stage between the pooling of mortgage loans and actual securitization. For more than 10 years, whole loans have been financed in the broker/dealer community through a combination of repurchase agreements and dedicated unsecured funds. More recently, some of the larger participants have created various derivative structures to expand their funding alternatives. However, repurchase agreements continue to be an important tool for financing. Although obviously not as secure as US Treasury collateral, whole loans still represent tangible assets. All else being equal, repurchase agreements collateralized by loans of tangible assets provide more reliable initial assurances as well as ongoing forecasts of quality, as compared to loans backed by financial assets.

Based on a survey of more than a dozen large market participants, we have found the following:

- The Cash Market for whole loan product has averaged approximately $1.5 trillion over the last 3 years.
- Approximately 60% completes the securitization process, which typically takes between 30 and 90 days to occur.
- This funding need of $900 billion, annually, equates to approximately $75 to $150 billion per month.
- Whole Loan repo volumes have ranged from $30 to $100 billion per month over this same period.

The largest participants in the market include Bank of America, Bear Stearns, Citigroup, Credit Suisse First Boston, Goldman Sachs, JPMorgan Chase, Lehman Brothers, Merrill Lynch Mortgage Capital, Morgan Stanley Securitized Products Group, UBS PaineWebber, and Wachovia.

The primary investors include foreign banks, private investors and corporations, especially insurance companies and finance companies. It also appears that public funds are beginning to explore this market for their cash collateral reinvestment. Some market participants indicated that a few funds are currently accepting whole loan repo as a reinvestment alternative.

The delivery of collateral is primarily via tri-party repo, with a smaller portion via hold-in-custody (HIC) transactions (previously known as safekeeping repo). Since the late 80's, when this product came under increasing scrutiny, HIC repo has been a less favorable method of delivery. However, the dealer community has taken significant steps to expand the documentation process to provide a higher degree of comfort around collateral segregation. The largest custodians for the repo market include Bank of New York, JPMorgan Chase, and Wachovia.

Our industry research is based, primarily, upon information from phone and email surveys with various market participants. Our findings and estimates are confined to this group. While we have applied our best efforts to use the data provided to us as efficiently and accurately as possible, we may have made errors or omitted considerations inadvertently. Any shortcomings in the data sets or the review are entirely our responsibility, although we cannot accept liability for the use of these findings for any purpose other than that of an informative nature. ASTEC's role throughout this process was one of compiler, engineer and advisor on industry practice.

Since 1980, ASTEC Consulting has provided research and technical services to many clients, including financial institutions, government agencies and technical support organizations. ASTEC's strengths are in analyses to define comparative peer groups and track the results of investment programs, prepare qualitative reviews, evaluate user/market needs, and exercise due diligence in contracting. In 1989, ASTEC began to develop research cooperatives to track changes in customer requirements. Currently, 250 institutional investors and 17 sponsors participate in ASTEC's securities lending research cooperatives. Beginning in 1993, ASTEC created a series of complementary databases to benchmark the risk-adjusted earnings of securities lenders and borrowers by asset class, management style, portfolio sector and security issue. There is no comparable data resource in the world for securities lenders, agents, counterparties, regulators and market supervisors -- as well as their consultants. If you would like any further analysis that explores the various elements mentioned above, please contact us.

Jack Huber
Managing Director
ASTEC Consulting Group, Inc.