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JUL 11 '05 PM 2:59 BOARD

July 6, 2005

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

Re: Comment Letter on Proposed Revisions to the Fidelity Bond and Insurance Coverage for Federal Credit Unions

Dear Ms. Rupp:

Thank you for the opportunity to comment on the National Credit Union Administration Board's (Board) proposed revisions to the Regulations concerning federal credit unions' fidelity bond and insurance coverage. The Board's Proposed Rule focuses on three change proposals and two comment solicitations. Overall, we agree with the three proposals except as outlined in this letter.

We believe allowing higher deductibles for credit unions eligible for Part 742 Regulatory Flexibility Program (Reg-Flex) is a positive change. Credit unions eligible for Reg-Flex must have capital that is more than 200 basis points higher than the "well capitalized," and possibly even higher if the credit union is subject to risk-based net worth requirements. This level of net worth certainly allows a credit union to absorb a higher deductible. In addition, a National Credit Union Administration (NCUA) determined CAMEL rating of 1 or 2 suggests risk management is appropriate, safety and soundness is solid, and National Credit Union Share Insurance Fund (NCUSIF) matters are not a concern.

However, the text of the proposed amended regulation should clarify the $1,000,000 maximum deductible for eligible credit unions is reached incrementally. The amended proposed text presently reads:

> *$2,000 plus 1/1000 of total assets up to a maximum of $200,000; for credit unions that qualify for NCUA's Regulatory Flexibility Program in Part 742, the maximum deductible is $1,000,000.*

This text carries the inference that when a credit union comes under Reg-Flex, the maximum deductible immediately jumps to $1 million. As the Supplementary Discussion points out, between $198 million and $998 million the deductible will exceed $200,000 but be less than $1 million, based on total assets.

The question of mandating higher minimum fidelity bond limits based on asset size warrants discussion.

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ASSET SIZE AND FIDELITY BOND INSURANCE

Asset size may be an easy gauge for insurance determination, but it does not measure risk. An $800 million credit union does not necessarily carry more risk than one at $100 million. With NCUA conducting risk focused examinations and supervising based on risk assessments, we think minimum bond coverage should also be tied to risk.

It is interesting the request for comment invites feedback on applying the risk concept, as conveyed through Reg-Flex, to the deductible but not the minimum level of the fidelity bond itself. We suggest the Board consider applying either Reg-Flex or the capital standards in the Prompt Corrective Action regulation as a more appropriate measure on which to link the minimum fidelity bond requirement.

FIDELITY BOND COVERAGE

Part 713.1 covers "...fidelity bonds for Federal credit union employees and officials and for other insurance coverage for losses such as theft, holdup, vandalism, etc, caused by persons outside the credit union." Two separate situations are covered here. One involves insiders and the other outsiders. We wonder what analysis NCUA has done, which group has caused the greater loss to credit unions, and how much of that affected the NCUSIF.

If employees and official family have caused significantly more loss than outsiders, increasing the minimum fidelity bond as assets increase appears sensible. However, the concept of risk should still enter into the equation. Management that adequately manages risk, maintains sound internal controls, and adheres to the guidance outlined in NCUA Letter 03-FCU-07 should pose less of an internal fraud risk than management that does not do these things.

If persons outside the credit union cause significantly more loss, perhaps the insurance focus should be on type of loss, type of coverage (basic or enhanced), and adequacy of coverage.

BASIC COVERAGE VERSUS ENHANCED/ADDITIONAL COVERAGE

The Regulation does not distinguish between basic and enhanced/additional fidelity bond coverage. Basic coverage alone, at present insurance minimums, may be insufficient to meet a credit union's needs. However, the same dollar minimum with enhanced coverage may be adequate.

For example, we have the minimum bond coverage dictated by our asset size. However, the basic bond does not cover the majority of loss we experience. There is a marked increase in outside fraud and losses due to plastic cards, forgery, alterations, and fraudulent deposits. Accordingly, based on our internal risk assessment, we expanded our insurance coverage and adjusted our deductibles.

We believe this is a prudent way to approach the Board's request for input on factors to take into account when considering additional coverage beyond the minimum amount. We suggest the board incorporate guidance that addresses the following:

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a) Internal risk assessment performed by credit union management;

b) Fraud trends and loss experience;

c) Need for enhanced bond coverage to cover such topics as Electronic Crime, Funds Transfer, Forgery or Alteration, Fraudulent Deposits, to name a few; and

d) Amount of deductible for enhanced or additional coverage.

In summary, we agree with the Board's proposals. However, we urge the Board to take another look at risk-based measures to determine minimum fidelity bond amounts. We also encourage the Board to provide enhanced guidance on adequacy of coverage. We appreciate adding our voice to the record.

Sincerely,

David M. Low

David M. Low
Director of Audit and Compliance

cc: Credit Union Association of Oregon
Credit Union National Association
Richard Hein, President/CEO, O.S.U. Federal Credit Union