



Credit Union National Association

cuna.org

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VIA E-MAIL – regcomments@ncua.gov

September 25, 2006

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

Re: CUNA Comments on Parts 703 and 704 – Permissible Investments
for Federal Credit Unions

Dear Ms. Rupp:

The Credit Union National Association (CUNA) appreciates the opportunity to comment on the proposed rule to expand the authority of federal credit unions (FCUs) to enter into investment repurchase transactions in which the instrument consists of first-lien mortgage notes. The authority will be expanded by allowing FCUs to purchase mortgage notes without the current membership restrictions. The proposal will also require that the investment repurchase agreements be subject to six safety and soundness conditions, which include a credit concentration limit, minimum credit rating, independent assessment of market value, maximum term of the repurchase transaction, custodial requirements for the transactions, and undivided interests in the mortgage notes. CUNA represents approximately 90 percent of our nation's 8,800 state and federal credit unions, which serve nearly 87 million members.

Summary of CUNA's Comments

- CUNA supports this proposal to invest in mortgage note transactions involving nonmembers. It will provide federal credit unions with options to improve their net income, for the benefit of their members. The proposal will not adversely affect the safety and soundness or risk management and it will not conflict with existing field of membership rules.
- We do not believe it would be necessary to require more than a tri-party custodial arrangement to identify the underlying loans.
- We do not believe these rules should establish additional underwriting criteria, impose other requirements regarding the quality of the mortgage notes, or

impose monitoring requirements, as these issues are already addressed in the Federal Credit Union Act (FCUA).

- Due to the short term nature of these types of investment repurchase transactions, we believe the long-term credit requirements should be deleted as it would be inappropriate to condition such short-term investments on long-term ratings.
- The requirement that the aggregate of the investments with any one counterparty must be limited to 25 percent of the credit union's net worth and the aggregate of all counterparties limited to 100 percent of its net worth is too low and is inconsistent with current NCUA rules.
- The requirement that the mortgage note repurchase transaction be limited to a maximum term of thirty days should be increased to ninety days as investment repurchase transactions traditionally have a maximum term limit of up to ninety days.

General Comments

CUNA generally supports the proposal that will allow FCUs to invest in mortgage note transactions involving nonmembers. This will provide FCUs with additional options to improve their net income and bolster their investment portfolios, the benefits of which can be shared with the members. The proposal is also consistent with the eligible obligations rule, which permits FCUs to purchase nonmember mortgage loans in order to complete pools of loans for sale on the secondary market, and it will not conflict with existing field of membership rules since FCUs will not be allowed to retain the underlying loans after the repurchase transaction terms expire. The investments involving nonmembers will also be low risk, due to their short term durations. While we generally support the proposal, we offer a number of suggestions for improvement that should make this investment activity more useful for credit unions.

Comments in Response to Issues Raised by NCUA

The following are CUNA's responses to the specific issues for which NCUA requested comment:

- *By what means can the party investing in mortgage note repurchase agreements easily identify the underlying loans, and is it necessary to require more than a tri-party custodial arrangement to accomplish this? If so, what additional requirements should be identified?*

CUNA's Response – It is our understanding that detailed loan schedules are standard information that is provided to the investing parties as part of the tri-party custodial statements, and they provide all the necessary information to identify the collateral. Therefore, we do not believe it is necessary to require more than a tri-party custodial arrangement to identify the underlying loans.

- *What minimum underwriting criteria, if any, should the rule address?*

CUNA's Response – We do not believe these rules should establish additional minimum underwriting criteria as these issues are adequately addressed in the Secondary Mortgage Market Enhancement Act (SMMEA), as incorporated in the FCUA. The FCU's board of directors would be in the best position to determine if additional criteria are necessary, based on the credit union's specific financial position and objectives.

- *What requirements, if any, should the rules address regarding the quality of the mortgage notes and their monitoring?*

CUNA's Response – We do not believe that the rules should address the quality of the mortgage notes and their monitoring, as these are addressed in the SMMEA, as incorporated in the FCUA. Again, the federal credit union's board of directors would be better suited to determine whether additional requirements are necessary with regard to the quality of the mortgage notes and their monitoring, based on the credit union's specific financial position and objectives.

- *The proposed minimum long-term credit rating for the counterparty is higher than has been previously included in Part 703 regarding investments for municipal securities. Given that the mortgage note repurchase transactions are typically short-term, should NCUA consider excluding long-term credit requirements for counterparties in mortgage note repurchase transactions?*

CUNA's Response - Due to the short term nature of these types of investment repurchase transactions, we believe the long-term credit requirements should be deleted as it would be inappropriate to condition such short-term investments on long-term ratings. The requirement to have the highest short-term credit ratings will adequately the risks associated with the strength of the counterparties.

- *What affect will permitting investment repurchase transactions using mortgage notes have on the safety and soundness of FCUs, the feasibility of the proposed standards for risk management, and the ability of FCUs to manage these investments safely?*

CUNA's Response – We believe this proposal will not adversely affect FCUs' safety and soundness or their risk management. This investment authority will provide FCUs with additional options to improve their net income and bolster their investment portfolios, the benefits or which may be shared with the members.

Comments in Response to the Six Safety and Soundness Requirements

- 1) *The aggregate of the investments with any one counterparty must be limited to 25 percent of the credit union's net worth and 100% of its net worth with all counterparties.*

CUNA's Response - These thresholds are too low and will unnecessarily limit the FCUs ability to use these investment vehicles. They are also inconsistent with existing NCUA rules. Part 703 of NCUA rules authorizes an FCU to invest in "investment repurchase transactions" as long as the securities the credit union receives are permissible investments, they or their agent obtain possession or control, the securities are valued daily, and the FCU maintains adequate margins that reflect a risk assessment of the securities and the term of the transaction. Part 703 also requires credit unions to develop investment policies that outline how the FCU will manage credit risk, including specifically listing institutions, issuers, and counterparties that may be used (or criteria for their selection), as well as limits on the amounts that may be invested with each.

The proposed rule classifies mortgage notes used in repurchase agreements as permissible investments and, therefore, the current rules described above should be sufficient. The current rules appropriately place the responsibility on the credit union and its board of directors to conduct risk assessments and adopt investment policies that clearly define their understanding of the investment activity, as well as factor in safety and soundness considerations.

Therefore, we believe the proposed aggregate limitations are unnecessary in light of the current rules. If NCUA believes that specific limitations are necessary, the preferable approach would be for the FCUs board of directors to establish the individual and aggregate investment limits.

2) At the time the FCU purchases the securities, the counterparty may not have debt with a long-term rating lower than A- or its equivalent, or a short-term rating lower than A-1 or its equivalent.

CUNA's Response - Due to the short term nature of these types of investment repurchase transactions, we oppose the restriction on long-term counterparty debt ratings as it would be inappropriate to condition such short-term investments on long-term ratings. The requirement to have the highest short-term credit ratings will adequately address the risks associated with the strength of the counterparties. For this reason, we request that NCUA remove the requirement regarding the long-term debt ratings of the counterparties.

3) The FCU must obtain a daily assessment of the market value of the repurchase securities using an "independent qualified agent," who is defined as an agent independent of an investment repurchase counterparty who does not receive a transaction fee from the counterparty and has at least two years experience assessing the value of loans.

CUNA's Response - We support this condition and agree it should be a standard part of these types of transactions.

4) *The mortgage note repurchase transaction is limited to a maximum term of thirty days.*

CUNA's Response - We believe a thirty-day term is not sufficient as investment repurchase transactions traditionally have a maximum term limit of up to ninety days. A ninety-day maximum period for mortgage note repurchase transactions would, therefore, be more appropriate and would allow FCUs to take full advantage of these investment opportunities without incurring any significant additional risks.

5) *These repurchase transactions must be conducted under tri-party custodial agreements.*

CUNA's Response - We support this condition, which is standard industry practice.

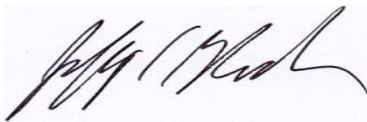
6) *The FCU must obtain an undivided interest in the securities.*

CUNA's Response - We support this condition, which is standard industry practice.

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Thank you for the opportunity to comment on the proposed rule to expand the authority of FCUs to enter into investment repurchase transactions. If you or other Board staff have questions about our comments, please give Senior Vice President and Deputy General Counsel Mary Dunn or me a call at (202) 638-5777.

Sincerely,



Jeffrey Bloch
Senior Assistant General Counsel