

January 18, 2012

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

re: National Credit Union Administration; Maintaining Access to Emergency Liquidity; 12 C.F.R. Parts 741; 76 Federal Register 79553, December 22, 2011

Dear Ms. Rupp:

The National Credit Union Administration (NCUA) Board (the Board) issued an advanced notice of proposed rulemaking (ANPR) on requiring federally insured credit unions (FICUs) to have access to backup federal liquidity sources for use in times of financial emergency and distressed economic circumstances. In issuing the ANPR, the Board notes that “[o]ne of the vital lessons learned from recent events is that institutions, both financial and otherwise, need to have an inviolable liquidity backstop that is over and above primary sources of funding such as tapping market sources of credit or selling highly liquid assets.” Part of the rationale for the ANPR is the scheduled 2012 closure of U.S. Central Bridge Corporate Federal Credit Union (USC Bridge) and corresponding redemption of Central Liquidity Facility (CLF) stock held by USC Bridge. This stock redemption could dramatically reduce the borrowing capacity of the CLF, limiting its ability to address a systemic liquidity event within the credit union industry.

The American Bankers Association (ABA)¹ agrees with the Board that part of sound risk management program and practices includes managing liquidity risk. Access to federal backstops is an important component of any liquidity risk management program. As part of any liquidity management program, ABA believes that FICUs should adhere to the same liquidity requirements that apply to all other federally-insured depository institutions. This would include significantly reducing the borrowing authority of the CLF and limiting taxpayer exposure to the CLF. In addition, the Federal Reserve’s Discount Window (Discount Window) is the most logical governmental backstop to address systemic liquidity events. The Board should require credit unions, especially larger credit unions, to arrange for a Discount Window access.

Background

Credit unions have several sources of emergency liquidity including the CLF, the Discount Window, advances from a Federal Home Loan Bank (FHLB), borrowings from Federal intermediate credit banks (which were merged with Federal Land Banks to form Farm Credit

¹ The American Bankers Association represents banks of all sizes and charters and is the voice for the nation’s \$13.8 trillion banking industry and its two million employees. The majority of ABA’s members are banks with less than \$165 million in assets. ABA’s extensive resources enhance the success of the nation’s banks and strengthen America’s economy and communities.

Banks), and highly liquid government securities. But for most FICUs, indirect membership in the CLF is their only source of emergency liquidity.

The CLF was established in 1979, before credit unions had access to the Federal Reserve's Discount Window or advances from a FHLB. To be eligible to borrow from the CLF, a credit union had to be a member of the CLF. A credit union may join the CLF directly by subscribing to CLF stock or indirectly through USC Bridge, as agent group representative. Only 1.3 percent of FICUs have direct membership in the CLF, while almost all FICUs qualify as members of CLF indirectly through USC Bridge.

The ability of the CLF to address systemic liquidity needs is governed by the level of CLF membership. The CLF's legal maximum borrowing authority is based on the amount of its total subscribed capital stock and surplus. By statute, the facility can borrow \$12 for every \$1 dollar of subscribed capital stock and surplus.

However, USC Bridge is scheduled to be closed in 2012. As part of its closure process, USC Bridge will redeem its CLF stock. According to NCUA, the maximum borrowing capacity of the CLF could fall from approximately \$50 billion to \$2.1 billion. As a result, a majority of credit unions that enjoyed access to CLF through this agent relationship will no longer have the CLF as a source of backup liquidity. The corresponding reduction in the CLF's borrowing capacity would also reduce the credit union system's capacity to address a systemic liquidity event.

Slightly less than 15 percent of FICUs report being members of a FHLB. However, 27 percent do not hold any mortgage assets, which would restrict their ability to use the FHLB for wholesale funding or liquidity needs.

ABA's Position

ABA believes that managing liquidity risk is part of any sound risk management practice and policy. Access to federal liquidity backstops is part of any sound liquidity risk management program. With the impending closure of USC Bridge and the corresponding redemption of CLF stock, ABA believes this is an ideal time for NCUA to visit the issue of liquidity risk management and emergency liquidity options for FICUs. Today, FICUs have evolved into modern financial institutions and should be required to adhere to the same liquidity standards that apply to all other federally-insured depository institutions.

ABA specifically recommends that until legislation is enacted to abolish the CLF, the Board should adopt policies that limit potential taxpayer exposure to the CLF. Additionally, the logical governmental backstop to address systemic liquidity risk is the Federal Reserve. Therefore, the Board should encourage FICUs to apply for access to the Discount Window.

CLF Is an Anachronism that Should Be Allowed to Fade Away

The CLF was established during an era when FICUs did not have access to alternative federal sources of liquidity. Since then, credit union liquidity options have grown and the CLF has

become an anachronism. From a public policy, various governmental reports have recommended ending the CLF or significantly curbing its borrowing authority.²

As previously mentioned, most FICUs only source of emergency liquidity is the CLF through USC Bridge acting as an agent group representative. However, the winding down of USC Bridge and the redemption of its CLF stock holdings could significantly shrink the borrowing capacity of the CLF unless natural person credit unions purchase CLF stock directly or other corporate credit unions purchase CLF stock as agents for their members.

In order to keep the CLF relevant, the Board in December 2011, adopted a rule that would deduct CLF stock investments from corporate credit union assets when calculating their capital ratios. The Board believes that this change in the denominator of the leverage ratio will facilitate the purchase of CLF stocks by corporate credit unions acting as an agent group representative and preserve the borrowing capacity of the CLF.

ABA believes – as we said in our October 5, 2011 comment letter – that this accounting gimmick to encourage corporate credit unions to buy CLF stock to address the credit union system liquidity is bad public policy and poses a safety and soundness risk to the National Credit Union Share Insurance Fund (NCUSIF).

Additionally, the CLF has been used as a vehicle for the NCUA to dispense financial assistance from the NCUSIF to troubled credit unions. This dispensing of financial assistance to troubled credit unions potentially undermines the orderly functioning of the NCUSIF and market discipline. It is equivalent to the open-bank assistance formerly provided by the Federal Savings & Loan Insurance Corporation and the Federal Deposit Insurance Corporation. Congress has expressed deep reservations about the practice of open-bank assistance by prohibiting the practice with the Leach Amendment to the Resolution Trust Corporation Completion Act. Also, in the Federal Deposit Insurance Corporation Improvement Act (FDICIA), Congress explicitly prohibited the Federal Reserve from acting as a source of liquidity for financial institutions in danger of failing. Therefore, ABA recommends that NCUA adopt standards consistent with the language in FDICIA with regard to advances to troubled credit unions through the CLF.

There are also policy and budget concerns associated with the CLF's borrowing authority. According to the 1997 Department of the Treasury study, the CLF had legal authority to advance billion of dollars to the NCUSIF without regard to its ability to repay. In a systemic crisis, taxpayers could be put at risk if advances from the CLF are used to shore-up troubled credit unions or a troubled insurance fund.

It will take legislation to abolish the CLF. Until legislation is enacted, ABA believes that the Board should take appropriate measures to limit taxpayer exposure to the CLF.

² Credit Unions, The U.S. Department of the Treasury, 1997 and Credit Unions: Reforms for Ensuring Future Soundness, United States General Accounting Office, July 1991.

Discount Window Is Logical Governmental Backstop

While FICUs have several governmental emergency liquidity options, ABA believes the Discount Window is the most logical governmental backstop to address systemic liquidity events.

The borrowing capacity of the CLF is limited to 12 times its subscribed capital stock plus surplus. The Discount Window does not have such borrowing limitations, making the Discount Window a superior source of emergency liquidity.

Moreover, the Federal Reserve is the preeminent liquidity lender of last resort. NCUA, in its Interpretive Ruling and Policy Statement (IRPS) No. 01-2, acknowledges that the CLF is *not* to be considered the lender of last resort.³

Therefore, ABA believes that NCUA should adopt the U.S. Department of the Treasury's 1997 recommendation that "[c]redit unions, particularly larger ones, should apply to their Federal Reserve Bank for discount window access."⁴

In fact, most FICUs are eligible to borrow from the Discount Window, even though few FICUs have applied for access to the Discount Window.⁵ To be eligible to borrow from the Discount Window, a depository institution must offer reservable transaction accounts (e.g., checking accounts) or nonpersonal time deposits.

ABA recognizes that there are some limitations associated with the Discount Window. For example, borrowings from the Discount Window are limited to 50 percent of paid-in and unimpaired capital and surplus, while borrowings from the CLF are not subject to this limitation.⁶ Additionally, some small credit unions may not qualify to borrow from the Discount Window; but ABA believes that there are sufficient alternatives to meet small credit unions' liquidity needs.

Treasuries and Borrowings from GSEs Are Unlikely to Meet Systemic Liquidity Needs

FICUs may borrow from a FHLB, as a source of contingent funding needs. FICUs may join the FHLB system if they hold at least 10 percent of their total assets in residential mortgage loans and meet certain other criteria.⁷

However, the evidence suggests that FHLBs may not adequately meet the systemic liquidity needs of FICUs. Currently, slightly less than 15 percent of FICUs are members of a FHLB. Additionally, 27.5 percent of all FICUs report not holding any mortgage assets and would be unable to rely upon a FHLB for wholesale funding or liquidity needs.

³ <http://www.ncua.gov/Resources/Documents/CLF/CLFIRPS01-2AdvancePolicy.pdf>

⁴ Credit Unions, The U.S. Department of the Treasury, 1997, p. 125.

⁵ Only 4.5 percent of FICUs have applied to access the Discount Window and only 3.3 percent of FICUs have collateral pre-pledged with the Federal Reserve.

⁶ Section 1757(9) of the Federal Credit Union Act.

⁷ 12 U.S.C. 1422(b)

In addition, Farm Credit Banks, the successor of the Federal intermediate credit bank, can extend credit to credit unions engaged in the making of loans to farmers and ranchers, and any corporation engaged in the making of loans to producers or harvesters of aquatic products, any note, draft, or other obligation with the institution's endorsement or guarantee, the proceeds of which note, draft, or other obligation have been advanced to persons and for purposes eligible for financing by production credit associations as authorized by this Act.⁸ The Federal Credit Union Act allows FICUs to borrow up to 100 percent of their paid-in and unimpaired capital and surplus from these institutions.

Once again, the evidence cast doubts on adequacy of the Farm Credit Banks to meet the emergency liquidity needs of FICUs. Very few FICUs are engaged in agricultural lending. Approximately 270 FICUs reported having any agricultural credit on their books as of September 2011. This means that almost 96 percent of FICUs could not use a Farm Credit Bank to meet their liquidity needs. Moreover, most FICUs have minimal holdings of agricultural credit and thus do not have the collateral to pledge for borrowings.

Treasury obligations with shorter maturities are another possible source of contingent liquidity. These debt instruments are traditionally highly marketable and very liquid. But this does not appear to be an option for most FICUs to meet their emergency liquidity needs. Over 91 percent of all FICUs do not hold any U.S. Treasury obligations.

Conclusion

In conclusion, with the impending closure of USC Bridge and the corresponding redemption of CLF stock, ABA believes this is an ideal time for NCUA to visit the issue of liquidity risk management and emergency liquidity options for FICUs. FICUs should be required to adhere to the same liquidity requirements that apply to all other federally-insured depository institutions. ABA believes that the best source of systemic liquidity is the Discount Window. The Board should require credit unions, especially larger credit unions, to arrange for Discount Window access. Additionally, until legislation is enacted to end the CLF, the Board should take the necessary steps to limit taxpayer exposure to the CLF.

If you have any questions, please feel free to contact the undersigned.

Sincerely,



Keith Leggett
Vice President and Senior Economist

⁸ 12 U.S.C. 2015 Section 1.7.(b)(1)(B)