American Bankers Association
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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; 77 Federal Register 44503, July 30, 2012

Dear Ms. Rupp:

The National Credit Union Administration (NCUA) Board (the Board) issued a proposed rulemaking for a federally insured credit union (FICU) to plan for or maintain access to emergency liquidity. The proposed emergency liquidity rule will incorporate a three-tiered approach based upon the size of the FICU. ALL FICUs with more than $10 million in assets must have a contingency funding plan and FICUs with more than $100 million in assets must demonstrate that they have access to at least one backup federal liquidity source. Part of the rationale for the proposed rule is the scheduled October 2012 closure of U.S. Central Bridge Corporate Federal Credit Union (USC Bridge) and the 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. This includes having in place written policies on contingency funding. ABA also agrees with the Board that the regulation should not be one-size-fits-all; but any liquidity management program should require FICUs to adhere to the same liquidity requirements that apply to all other federally-insured depository institutions. Moreover, ABA believes that access to federal backstops can be an important component of any liquidity risk management program.

However, with the closing of USC Bridge and the redemption of its CLF stock holdings, the borrowing capacity of the CLF could be dramatically reduced. ABA is concerned that this will limit the CLF's ability to address systemic liquidity events within the credit union industry, making the CLF into an inadequate governmental backstop. In addition, while ABA appreciates the Board's inclusion of the Federal Reserve's Discount Window (Discount Window) as a possible governmental backstop to address systemic liquidity events, the Board should require larger credit unions to arrange for Discount Window access. Furthermore, ABA requests that the Board reconsider its position that membership in a Federal Home Loan Bank (FHLB) will not count as an emergency liquidity backstop option under the proposed rule. FHLBs play an important role in providing liquidity to banks and FICUs.

[1] The American Bankers Association represents banks of all sizes and charters and is the voice for the nation's $14 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.

Background

Credit unions have several sources of emergency liquidity including the CLF, the Discount Window, advances from a FHLB, borrowings from Federal intermediate credit banks (which were merged with Federal Land Banks to form Farm Credit Banks), and highly liquid government securities. But for most FICUs, indirect membership in the CLF is their only source of emergency liquidity.[2]

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 from any source $12 for every $1 dollar of subscribed capital stock and surplus. Currently, the maximum borrowing authority of the CLF is approximately $46 billion.

However, USC Bridge is scheduled to be closed in October 2012. As part of its closure process, USC Bridge will redeem its CLF stock. The redemption of the USC Bridge's CLF stock could shrink the maximum borrowing capacity of the CLF from approximately $46 billion to $1.9 billion. This corresponding reduction in the CLF's borrowing capacity would reduce the credit union system's capacity to address a systemic liquidity event.

In addition, a majority of credit unions that enjoyed access to CLF through this agent relationship may no longer rely on the CLF as a source of backup liquidity.

The Proposal

The proposed rule on emergency liquidity incorporates a three-tiered approach, based on the size of the federally insured credit union:

- Credit unions under $10 million in assets would have to maintain a written liquidity policy approved by their board. The policy would provide a basic framework for managing liquidity and having a list of contingent liquidity sources in emergency situations.

- Credit unions with more than $10 million in assets would have to establish a formal contingency funding plan that clearly sets out strategies for addressing liquidity shortfalls in emergency situations.

[2] NCUA has estimated the number of FICUs that have access to the CLF through the indirect membership at 6,019.

- Credit unions with more than $100 million in assets would also have to demonstrate access to at least one of the following three options for a backup federal liquidity source:
    - becoming a member of the CLF;
    - becoming a CLF member through a CLF agent; or
    - establishing direct borrowing access to the Federal Reserve's Discount Window.

The Board states that a written contingency funding plan should take into consideration the complexity, risk profile, and scope of operations of a FICU. The written contingency plan should at the minimum include:

(1) The sufficiency of the institution's liquidity sources to meet normal operating requirements as well as contingent events;
(2) The identification of contingent liquidity sources;
(3) Policies to manage a range of stress environments, identification of some possible stress events, and identification of likely liquidity responses to such events;
(4) Lines of responsibility within the institution to respond to liquidity events;
(5) Management processes that include clear implementation and escalation procedures for liquidity events; and
(6) The frequency that the institution will test and update the plan.

ABA's Position

ABA believes that managing liquidity risk is part of any sound risk management practice and policy. A part of any liquidity risk policy is the adoption of a written contingency funding plan. ABA also believes that access to federal liquidity backstops is part of any sound liquidity risk management program.

With the pending October 2012 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 has no objection to the three-tiered approach being proposed by the Board. NCUA justified the tiered regulatory approach based upon its analysis of emergency liquidity ratio for FICUs.[3] NCUA found a positive relationship between the emergency liquidity ratio and the asset size of a FICU, meaning larger credit unions may be more susceptible to a liquidity event.

In addition, the Board determined that the very smallest credit unions present relatively limited safety and soundness liquidity concerns, as these institutions tend to have lower loan-to-share ratios, shorter duration assets, and higher amounts of balance sheet liquidity than larger credit unions.

[3] The emergency liquidity ratio is computed by dividing total deposits by the sum of cash plus investments less than one year.

There are some within the credit union industry objecting to the proposed three-tiered regulatory approach because it is dividing the credit union industry.[4] ABA does not share this viewpoint and believes such tiered regulation is far better than a one-size-fits-all standard.

The remainder of ABA's comment letter will focus on the following points:

- the CLF may not adequately meet the systemic liquidity needs of the credit union industry;

- large FICUs should be required to apply for access to the Discount Window; and

- the Board should reverse its position that FHLB membership is not an option for emergency liquidity.

CLF May Not Meet FICUs' Emergency Liquidity Needs

Over 6,000 FICUs currently have access to the CLF by belonging to a corporate credit union that is in turn part of the agent group headed by USC Bridge. The closing of USC Bridge and the redemption of its CLF stock holdings could significantly impact the emergency liquidity options for the vast majority of FICUs and could significantly shrink the borrowing capacity of the CLF,[5] thereby limiting the CLF's ability to address systemic liquidity. As a result, ABA believes that the CLF may not adequately meet the future emergency liquidity needs of FICUs, especially during a systemic liquidity event.

ABA believes that the purchase of CLF stock by corporate credit unions acting as agent group representatives or the direct purchase of CLF stock by FICUs will not offset the diminished borrowing capacity arising from the redemption of USC Bridge's CLF stock holdings.

A corporate credit union acting as an agent for its members must subscribe to CLF capital stock in an amount equal to 0.5 percent of its paid-in and unimpaired capital and surplus of its members. However, in the proposed rule, the Board acknowledges that many corporate credit unions cannot afford to purchase stock for all their member credit unions, as required by the Federal Credit Union Act and NCUA regulations. This would mean many FICUs would not have access to the CLF for emergency liquidity.

In addition, the Board believes that there are natural person credit unions that are willing and financially able to become regular members of the CLF. However, they have been hesitant to do so by the administrative requirements of regular membership and the provisions of the CLF Repayment, Security, and Credit Reporting Agreement governing extensions of credit. The Board is of the opinion that corporate credit unions can assist FICUs to overcome their reticence to purchase CLF stock directly by acting as advisors.

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[4] http://newyorksstateofmind.wordpress.com/2012/07/25/divide-and-crumple/
[5] The maximum borrowing capacity of the CLF could shrink from approximately $46 billion to $1.9 billion.

But ABA believes that very few credit unions will seek to become direct members of the CLF. According to the June 2012 unaudited financial statements for the CLF, the capital stock of regular members fell from $75,450,654 as of June 2011 to $66,176,534.02 one year later.[6]

Therefore, many FICUs will lose access to the CLF as a source of emergency liquidity and the borrowing capacity of the CLF will be greatly diminished. While the CLF may be able to meet the liquidity needs of individual FICUs, it will not be able to handle the liquidity needs of FICUs during a systemic liquidity event.

Large Credit Unions Should Be Required to Use the Discount Window

The proposed rule identifies three federal backup liquidity options for credit unions with over $100 million in assets – becoming a member of the CLF, becoming a member of the CLF through a CLF agent, and establishing access to borrow from the Discount Window. Of the three options, ABA believes the Discount Window is the most logical governmental backstop to address systemic liquidity events.

Most FICUs are already eligible to borrow from the Discount Window, even though few FICUs have applied for access to the Discount Window.[7] 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. Out of 1,434 FICUs with assets in excess of $100 million, only 10 FICUs do not offer share draft accounts (checking accounts).

In addition, 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.

In addition, unless natural person credit unions directly subscribe to CLF capital stock or corporate credit unions subscribe to the capital stock of the facility on behalf of credit unions in their membership, the borrowing capacity of the CLF could be severely limited and will not effectively address any systemic liquidity event. Once again, this limitation does not apply to the Discount Window.

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.[8]

Therefore, ABA believes that NCUA should adopt the recommendation from the U.S. Department of the Treasury that "[c]redit unions, particularly larger ones, should apply to their Federal Reserve Bank for discount window access."[9]

[6] http://www.ncua.gov/Resources/Documents/CLF/CLF2012-06.pdf
[7] 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.
[8] http://www.ncua.gov/Resources/Documents/CLF/CLFIRPS01-2AdvancePolicy.pdf
[9] Credit Unions, The U.S. Department of the Treasury, 1997, p. 125.

FHLB Membership Should Be an Emergency Liquidity Option

The proposed rule excludes FHLB membership as an emergency liquidity option for credit unions. While the Board recognized that the FHLBs provide valuable services to credit unions of all sizes, the Board concluded “that the FHLBs are private institutions which are not obligated, and may not be able, to meet emergency liquidity demands in the same way the Discount Window and CLF are statutorily designed to do.”

However, the evidence shows that the Federal Home Loan Bank (FHLB) system was an important source of systemic liquidity during the recent financial crisis. Advances from FHLBs provided member institutions with needed liquidity at the very moment that credit markets became frozen. Therefore, ABA believes that the Board should include FHLB membership as an emergency liquidity option.

Conclusion

With the imminent 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. ABA has no objection with NCUA adopting a three-tiered regulatory approach and agrees that part of liquidity risk policy is the adoption of a written contingency funding plan. But ABA believes FICUs should be required to adhere to the same liquidity requirements that apply to all other federally-insured depository institutions.

ABA believes that larger credit unions should make arrangements to access the Discount Window. The Discount Window is superior to the CLF in meeting large credit unions’ emergency liquidity needs. ABA also encourages the Board to include FHLB membership as an emergency liquidity option.

ABA also has deep concerns that the CLF may not adequately meet the future systemic liquidity needs of FICUs. The purchase of CLF stock by corporate credit unions acting as an agent group representatives or the direct purchase of CLF stock by FICUs will not be sufficient to offset for the diminished borrowing capacity of the CLF arising from the redemption of USC Bridge’s CLF stock holdings. Finally, 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