



June 27, 2007

Ms. Linda Jekel  
Director of Credit Unions  
Department of Financial Institutions  
PO Box 41200  
Olympia, WA 98504-1200

RE: Comments on Revision 3 - Discussion Draft of Proposed Rules  
Credit Union Alternative Share Insurance Programs  
Posted June 15, 2007

Dear Ms. Jekel:

We appreciate the opportunity to comment on the State of Washington, Department of Financial Institution's (DFI) above-referenced Revision 3 discussion draft of proposed rules dated June 15, 2007. American Share Insurance (ASI) is pleased to provide its comments in an effort to assist the DFI as it moves to finalize the drafting of workable and pragmatic rules to govern the application and supervision process with respect to alternative share insurance programs for its state-chartered credit unions.

This letter is our third in a series addressing the subject matter of the proposed rules, and we wish to make note of the significant progress being made in each and every version, and thank the DFI for its consideration of our previous comments. In reviewing Revision 3 we observe certain key factors that would have significant impact on an alternative share insurance program seeking admission under RCW 31.12.408 and WAC 208-800. Our comments follow.

**WAC 208-800-030 - Definitions.**

- Item (1) "Access to additional sources of funds" - RCW 31.12.408 already defines such sources of funds as including "replenishment features, reinsurance or other sources." The June 15, 2007 draft, as well as previous versions, specifically excludes the replenishment of funds through "premium of insured claims." This phrase is unclear and leads us to believe that we cannot consider otherwise permissible reassessments or premiums from our insured credit unions as "additional sources of funds." Also, Ohio law permits the company to solicit subordinated surplus capital from participating credit unions or other organizations which could also be considered "additional sources of funds." Is the DFI essentially saying that such replenishment shall not come from the reassessment of, or premiums charged, insured credit unions? A revision to include the underlined phrase would clarify this provision for any alternative share insurance program.

□ Item (2) “Adequate reserves”

**Definition of Reserves** - Section WAC 208-800-030 of the draft rules fails to define the term “reserves.” Lacking response to our April 30, 2007 comment letter regarding this critical definition, we concluded in our May 30, 2007 comment letter that the term means the sum of all on-book reserves and capital accounts, as well as capital available through reassessments, subordinated debt issuances or other sources of funds. We believe the term “reserves” needs defined in the rules and recommend the following for your consideration:

“**Reserves**” means the sum of the alternative share insurance program’s recorded loss reserves, retained earnings, primary insured credit union capital contributions (deposits), subordinated surplus and all other capital contributions accessible through reassessment or premium charges made of the alternative share insurance program’s primary insured credit unions as permitted by contract or statute.

**Stress Tests Fallacies** - The June 15, 2007, draft of the proposed rules continues to contain “stress tests” suggested by the NCUA that were developed over 10 years ago based on irrelevant outdated information and the application of impractical loss exposure assumptions. In principle we disagree with the stress test approach in determining the adequacy of the alternative share insurance program’s reserves, and encourage the DFI to consider rewriting this definition to simply require the assessment of an independent actuary.

Specifically, ASI believes that the first two stress tests proffered by the NCUA focus on the wrong targets – the larger credit unions. Empirical evidence supports the fact that losses incurred by the NCUSIF, and ASI, are almost always in smaller credit unions. The average asset size of over 3,000 federally insured credit unions that failed between 1981 and 2004 was approximately \$2 million, not \$2 billion. In fact, the NCUSIF has never experienced a loss in a natural-person credit union of greater than \$250 million in assets.

While lesser in number, the asset size of ASI’s average credit union failures for all 33 years of operations has been \$2.2 million. History shows that the larger the credit union failure, the lower the claim as a percentage of total assets of the failed credit union. In 33 years, ASI has experienced only two losses associated with credit unions with assets over \$10 million. The loss per credit union on those two failures was 0.11% of total assets. This compared favorably to the 3.60% loss ratio for all 110 claims paid by ASI since incorporating in 1974.

Accordingly, the first two stress tests (single largest and the average of three of the top ten) provide no real affirmation of the adequacy of reserves. ASI believes the best way to determine sufficiency of reserves is to have an independent actuary make such assessment. Under Ohio law, ASI is required to secure an opinion from an independent actuary as to the adequacy of its loss reserves annually, and an opinion as to the adequacy of its total capital no less than every three years. These independent analyses are performed in conformity with standards of the actuarial profession and give consideration to industry loss frequencies and amounts, as well as the actual claims activity of the fund under review. Actuarial studies are broadly accepted as the best means for assessing the adequacy of reserves.

The third suggested stress test encompassing the failure of all CAMEL 4 and 5-rated credit unions also lacks value and is absolutely unnecessary as well. While the probability of failure in this grouping is significantly greater than that of the single largest credit union or the average of three of the top ten in tests numbers one and two, their loss exposure is easily determinable and generally already adequately reserved for on the books of the alternative share insurance program.

These problem credit unions are always under closer supervision by the insurer and the regulator, and as a result the element of a surprise loss is usually non-existent. Furthermore, generally accepted accounting principles (GAAP) require that the loss exposure estimates for these credit unions be provided for through adequate loss reserves on the books of the insurer, so stress testing CAMEL 4 and 5-rated credit unions really doesn't add to the DFI's assessment of the adequacy of an alternative share insurance program's reserves.

The June 15, 2007 draft added one more stress test to the mix requiring that the alternative share insurance program be able to withstand "...the repetition of the worst loss period in the NCUSIF's history (currently 1981-1983)." We argue that using the 1981-1983 data provides no real assessment of our adequacy of reserves. Confirmation of ASI's ability to withstand losses of this nature is obvious in the fact that ASI already survived that period. During this period, ASI reported a lower loss ratio (claims paid per assets of the failed credit unions) and lower failure frequency rate than the NCUSIF did. However, that was over 25 years ago, and the risk profile and loss patterns of credit unions have changed dramatically since 1983.

The method of assessing the adequacy of an organization's reserves must be logical and current to provide a realistic view of the quality of the private provider, and this would be best accomplished through the employment of the services of an independent actuary, not the application of irrelevant and outdated stress tests. We ask your reconsideration of the current approach.

***Definition of Failure*** - If the DFI elects to retain the stress tests in the definition, then we think it is imperative that the terms "failure" and "recover" be defined. Lacking such definitions make it impossible for an alternative share insurance program to know if it could satisfy these various stress tests. We suggest that the term "failure" be defined as any event of capital impairment or other financial deficiency experienced by a participating credit union that results in a claims loss being paid by the alternative share insurance program to: (1) individual credit union members as a result of a liquidation; (2) a continuing credit union as the result of a merger or purchase and assumption transaction; or, (3) to a participating credit union as capital assistance to remedy that credit union's capital impairment.

***Definition of Recover*** - As for the term "recover," we again believe certain quantitative factors need to be considered in the rules. We suggest that recovery be tied to the alternative share insurance program's minimum operating level or equity ratio required by its governing statute in its state of domicile. Under Ohio law, ASI's minimum operating level (equity ratio) is 1.0% of total primary insured shares. [ORC §1761.10(A)(1)] Alternatively, we would recommend that the DFI consider recovery a condition in which the alternative share insurance program reports an equity ratio of no less than the minimum required level imposed of the NCUSIF under The Federal Credit Union Act, or 1.20% of insured shares. [U.S.C. §1782a(c)(2)]

***Other Issues*** - Finally, this definition closes by stating that the alternative share insurance program's reserves "must meet regulatory safety and soundness standards, with the highest level of safety for share accounts." [Emphasis added.] This phrase suggests double standards, inferring that the DFI could apply another set of standards in determining the adequacy of reserves even if the alternative share insurance program satisfies the aforementioned stress tests or receives a favorable report from an independent actuary. The inclusion of this last sentence is conflicting, nonspecific, confusing and should be deleted.

- Item (8) "Equity ratio" - We continue to be confused by the inclusion of the reference to the equity ratio being the ratio "as established by the NCUA board as the normal operating level." The equity ratio is simply the defined components of the numerator divided by the defined components of the denominator. What the NCUA establishes as their specific normal operating level is irrelevant in defining how the equity ratio is computed or defined, plus it will vary based on NCUA's specific outlook with respect to their insured credit unions. If the DFI wishes to establish a minimum allowable equity (operating) level, then it should be so defined in this section, or separately.
- Item (13) "National geographic diversity" - The proposed draft redefines geographic diversity solely as that of diversity of economic risk. In 1996, when RCW 31.12.408 was passed by the legislature, the State's governing body was concerned over the lack of "geographic diversity" of the Washington Credit Union Share Guaranty Fund, not its financial stability due to economic risk. We contend the proposed rules attempt to rewrite the law by introducing new terms such as "economic diversity" and using this new measurement device to determine the acceptability of an alternative share insurance program.

Other means for measuring diversity includes an assessment of the alternative share insurance program's distribution of insured savings based on the core employment base of individual credit union members. Also, the DFI must give some weight to the fact that private share insurance currently operates in only nine states, and only approximately seven other state credit union acts include statutory language permitting for a private insurance option subject to regulatory approval, as in Washington. Accordingly, to compare a private sector company's diversity of business to that of a federal agency, which has no state boundary limitations or barriers of entry, is unreasonable and biased. The equivalency mandate of the law must be more flexibly applied in the rule, or the law will be proven to be too restrictive and inoperative.

- Item (20) "Replenishment" - The term "allowable minimum percent" is referred to as the benchmark equity ratio that would trigger replenishment of funds by the alternative share insurance program; however, there is no definition of what the "allowable minimum percent" is or how it is to be determined and set by the DFI. Under Ohio law, ASI's minimum operating level (equity ratio) is 1.0% of total primary insured shares. [ORC §1761.10(A)(1)]

**WAC 208-800-100 - Contents of application to do business in Washington State as an alternative share insurance program.**

- Introductory paragraph - The subject draft continues to require that an applicant and operating alternative share insurance program “must be an authorized insurer in compliance with Title 48 RCW.” This requirement is in conflict with RCW 31.12.408, which does not require that an “alternative share insurance program” be an authorized insurer under RCW 48. The very use of the term “alternative share insurance program” in the law suggests that the legislature was well aware of the fact that share insurance programs were not traditional insurance companies. Further, we believe that share insurance programs were never designed to function or license like that of a traditional property or casualty company, and to require this licensure will likely eliminate any private sector share insurance companies from qualifying under this version of the proposed rule. Our reasoning follows.

This provision runs contrary to the principle of “equivalency” which is pervasive throughout RCW 31.12.408 and other sections of the proposed rules in that, it requires the alternative share insurance program be held to a higher standard than that applied to the NCUSIF. Our argument is supported by the fact that under RCW 48.05.045, government agencies, such as the NCUA, are exempt from the licensure requirements of RCW 48. Specifically, RCW 48.05.045 states:

“No certificate of authority shall be issued to or exist with respect to any insurer which is owned and controlled, in whole or in substantial part, by any government or government agency.”

Second, when non-federal share insurance for credit unions was first enabled under state laws in the early 1970s, the intent was to allow private, cooperative, credit union-owned programs to provide coverage similar to that of the NCUSIF. (A detailed explanation of the legislative and operational history of nonfederal share insurance, and ASI, was supplied in ASI’s May 30, 2007 comment letter.) Reasons why the NCUSIF -- and nonfederal alternative share insurance programs -- were never intended to be traditional insurance can be found within RCW 48. Basic requirements of RCW 48 impede ASI, as well as the NCUSIF, from ever being able to insure all credit union shares. For example, RCW 48.11.140 (1), states:

“An insurer may not retain any risk on any one subject of insurance, whether located or to be performed in this state or elsewhere, in an amount exceeding ten percent of its surplus to policyholders.”

A literal interpretation of RCW 48.11.140(1) means that the NCUSIF at December 31, 2006 -- if subjected to Washington’s insurance code -- would have been prohibited from insuring any credit union over \$710 million in insured shares (10% of their surplus to policyholders), or 122 credit unions nationally. These credit unions represent about one-third, or \$198 billion, of the total shares currently insured by the NCUSIF as of that date. Closer to home, this would mean that the NCUSIF could not insure Washington-chartered Boeing Employees Credit Union with \$4.9 billion in insured shares or Washington State Employees Credit Union with \$953 million in insured shares.

Imposing RCW 48.11.140(1) upon ASI, effectively establishes a new statutory requirement not currently part of RCW 31.12.408, and holds alternative share insurance programs to a standard not equally applied to the NCUSIF. With this provision, the proposed rules would inconsistently apply the principles of equivalency and automatically discriminate against nonfederal private companies in favor of federal insurance.

- Item (14)(c)/(d)/(e) - These subsections require the submission of information without clarifying exactly what is being requested. The use of the term “concentration of risk” causes confusion. For example, Item 14(c) requires a “Distribution and concentration of risk of contracted credit unions by asset size.” This may be better solicited by requesting a “Listing of contracted primary insured credit unions by asset size.” In fact, Items 14(c), (d) and (e) could be consolidated into one provision stating: “Listing of contracted primary insured credit unions by state, by asset size and by total insured shares.”

Further, we would request that this section be amended to include a requirement (14(f)) that the alternative share insurance program provide a listing of primary insured credit unions by their core sponsor group and CAMEL, or equivalent measurement, rating.

- Item (16) - ASI believes the inclusion of this provision requiring an alternative share insurance program supply the DFI with a “...copy of a certificate of authority issued by the Washington State Office of the Insurance Commissioner authorizing the insurer to transact insurance...” is inappropriate and should be stricken. We contend that the licensure requirement: (1) applies a standard not “equivalent” to those applied to the NCUSIF; (2) establishes a requirement not required under RCW 31.12.408; (3) contradicts the legislative intent of RCW 31.12.408; and, (4) makes the rules inoperable under current conditions.

#### **WAC 208-800-200 - Process for approval of application.**

- No comments.

#### **WAC 208-800-300 - Post-approval requirements for alternative share insurance programs.**

- Items (2) - This section does not provide a realistic or fair remedy to the alternative share insurance program in the case of a technical default on a rule/statute requirement. There is no relief in the case of a default other than to notify affected state-chartered credit unions, then hold a hearing that could conclude in a decision by the director to force the affected credit unions to convert back to federal insurance. We believe that there should be a series of prescribed remedy provisions provided to maintain stability and calm within the Washington credit union movement and afford the alternative share insurance program a reasonable time period in which to correct any deficiency.

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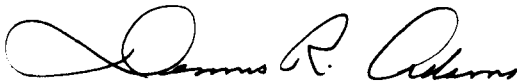
For example, there should be a provision in the rules that if an alternative share insurance program's equity ratio falls below the DFI's "allowable minimum" equity ratio level, that the alternative share insurance program could be allowed to submit a plan for recapitalization acceptable to the Department. Or, instead of forcing the privately insured credit unions in Washington to seek federal insurance, the DFI could place a moratorium on the approval of additional credit unions seeking to be insured by the alternative share insurance program until the specific deficiency is remedied under an agreed-upon plan of action. The current proposal creates unnecessary regulatory burden and instability in the long-term viability of an approved alternative share insurance program's operations in Washington and elsewhere. The DFI's approach is inconsistent with normal regulatory due process and contrary to the way credit unions are generally supervised under Title 31 of RCW.

**WAC 208-800-400 - General provisions.**

No comments.

We sincerely appreciate the opportunity to comment on the DFI's proposed rules and hope that they prove helpful with the development of the final rules. We would be pleased to answer any questions you may have regarding our comments.

Respectfully submitted,



DENNIS R. ADAMS  
President/CEO

DRA/krb