Via e-mail

May 17, 2004

Director@fasb.org

TA & I Director
Financial Accounting Standards Board
401 Merritt
P.O. Box 5116
Norwalk, CT 06856-5116
Re: Setoff and Isolation

Ladies and Gentlemen:

U.S. Central Credit Union appreciates the opportunity to comment on the April 9, 2004 FASB Staff Request for Information concerning setoff and legal isolation issues (the "RFI"). Our comments relate only to loan participations in loans originated by credit unions.

In that regard, we note that other respondents have discussed the legal distinction between credit union shares and bank deposits that eliminate the common law right of setoff with respect to such shares. Accordingly, we will not restate this difference. However, there is another key difference between a credit union in liquidation by a receiver and a bank liquidation by the FDIC with respect to loan participations.

In the RFI, FASB staff notes that in a bank liquidation the setoff of a loan and a deposit made by the borrower results in an unsecured general claim against the originating bank for a participant in that loan. Assuming that this is correct, the participant would not typically receive its share of the amount set off because, as an unsecured general creditor, it would stand behind depositors of the bank in payout priority. It also could be argued that the deposit insurer of the failed bank would have an incentive to set off deposits against the loan and thus shift a participant to the status of an unsecured general creditor of the failed bank for its pro rata amount of the repayment of the loan evidenced by the setoff. There is no such incentive in the case of the liquidation of a credit union.

In the case of a liquidation of a credit union, the borrower might have a common law right of setoff. However, that right could not be exercised to set off a debt obligation to the credit union against equity shares of the credit union. In addition, assuming a properly drafted participation agreement provides for the allocation of payments received through application of a right of setoff, there is no incentive for the NCUSIF as liquidator of the credit union to exercise any setoff as that would merely create another unsecured claim for a payment obligation of the failed credit union. This payment obligation must be satisfied in liquidation before any member receives a payout on their shares. This occurs because of application of what is commonly referred to as "creditor priority".

Creditor priority is one way in which the equity nature of credit union shares is reflected. Application of creditor priority means that all creditors of a credit union in liquidation are paid in full before members receive any return of their credit union shares. Creditor priority is found in 12 CFR 709.5 for federally insured credit unions. State statutes also provide for creditor priority for state-chartered credit unions.
For example, the Kansas Credit Union Act, K.S.A. 17-2230(c) establishes creditor priority for Kansas credit unions. Other states have similar provisions. Accordingly, because of creditor priority, it is virtually impossible for participants in credit union loans to suffer any loss attributable to the setoff of any loan of an originating credit union.

The RFI also noted that the Board recently discussed a change to defining isolation of financial assets to mean that the values of those assets to the transferees does not depend on the financial performance of the transferor and is not affected by bankruptcy, receivership, or changes in the creditworthiness of the transferor. We are concerned that the change expands the concept of legal isolation to the point that few, if any, transactions in financial assets could qualify as a sale, unless the Board were to carve out explicit exceptions.

In summary, we believe that the apparent concern with setoff rights, in the case of loan participations, has no practical applicability to credit union originated loans. We are also opposed to the implementation of the change in the definition of legal isolation.

Thank you for the opportunity to provide these comments. If you have any questions about this letter, please contact Henry Dyhouse, our Associate General Counsel at (913) 227-6002.

Sincerely,

Francois Henriquez
Senior Vice President and General Counsel
U.S. Central Credit Union

5/20/2004