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August 23, 2011

Ms. Mary Rupp

National Credit Union Administration Board
1775 Duke Street
Alexandria, VA 22314-3486

Re: Comments on Part 703 ANPR, Financial Derivatives Transactions to Offset Interest Rate Risk

Dear Ms. Rupp:

This comment letter represents the views of the Credit Union National Association (CUNA) regarding NCUA's advance notice of proposed rulemaking (ANPR) on financial derivatives to offset interest rate risk (IRR). By way of background, CUNA is the largest credit union advocacy organization in this country, representing approximately 90% of our nation's 7,300 state and federal credit unions, which serve about 92 million members.

We commend the Board for initiating a rule making process on the use of derivatives within natural person credit unions to help manage risks associated with changing interest rates. Moreover, we agree with the Board that credit unions should have tools to facilitate their operations, such as financial derivatives to hedge IRR, as long as they are consistent with vigilant risk management on the credit union's part and reasonable supervision from regulators. We support this proposal and offer some recommendations concerning issues to be addressed in a subsequent proposed regulation.

Discussion

We agree with the premise of the ANPR that credit unions should be able to use derivatives products to help mitigate IRR. Such products can allow credit unions to maintain margins on their fixed-rate loan portfolios and thus, facilitate the availability of credit unions to continue making loans to their members. We agree that the appropriate approach would be to amend Part 703 to allow the use of financial derivatives to hedge IRR as a permissible investment activity.

Currently, NCUA allows a limited number of natural person federal credit unions (FCUs), on a case-by-case basis, to engage in derivatives to hedge IRR through an investment pilot program. Under the program, some

investment activities that would otherwise be prohibited under Part 703, are allowed for participating credit unions. Should NCUA choose to regulate in this area, which we would support, we believe the existing investment pilot program, either through a third-party or if the credit union has independent authority, should be grandfathered.

Access to Derivatives Counterparties and Products

A regulation on the use of derivatives for IRR risk management should, in our view, provide a sufficient number of eligible derivatives counterparties to provide credit unions with greater access to products and more competitive pricing. Also, derivative products used by credit unions should include access to over-the-counter (OTC) derivatives that are currently allowed under the investment pilot program. In addition, certain exchange-traded derivatives may be appropriate for well-managed credit unions as long as they comply with any counterparty requirements, as applicable, as addressed in a regulation. Moreover, we support allowing credit unions to seek independent authority to engage in derivatives that does not involve a third-party, subject to meaningful but not overly burdensome qualifications the credit union would be required to meet.

Certain Issues with the Current Investment Pilot Program

Currently, NCUA's investment pilot addresses the financial condition of the participating credit union, the involvement of its Board of Directors, accounting issues, counter-party credit rating, hedging, modeling, internal controls, and legal issues. There are other requirements for credit unions with independent authority to engage in derivatives hedging activities.

One concern that credit unions have raised with us is that while they agree there should be appropriate standards for counterparties, some otherwise appropriate counterparties may be impermissible if the current investment pilot standards are incorporated into the regulation. Regardless of the standards, we believe there should be sufficient flexibility to allow access to a greater number of eligible counterparties, which may lead to access to different products and more competitive pricing for credit unions.

Currently, the maximum limit on derivatives exposure must not exceed 250% of a credit union's net worth. If NCUA incorporates a maximum limit on derivatives exposure, we recommend that the limit not be based on a percentage of net worth. That is because net worth does not account for IRR and a net-worth-based standard will likely create additional risk when derivatives positions have to be adjusted as a result of changes to net worth. Instead, a credit union should be able to use derivatives to hedge up to 100% of its fixed rate loan portfolio.

Regarding the involvement of the credit union's board, we believe that while a credit union's board should understand, set the parameters of, and

monitor the derivatives program and risk management policy, a credit union board should not have to approve each transaction in its day-to-day operations. The investment pilot program currently requires the credit union board to understand, review, and approve each transaction prior to execution.

The current requirement to immediately terminate transactions when the counterparty is downgraded to BBB will likely be disruptive to the credit union, which could suffer increased risk. We think a more reasonable approach would be that a credit union should not be allowed to enter into new transactions after a counterparty has been downgraded.

A Credit Union's Size Alone Should Not Preclude Participation

We believe well-managed credit unions of all sizes, including smaller credit unions, should have access to derivatives to hedge IRR as part of their effective risk management program, should they choose to engage in such activities. We do not think that small credit unions should be eliminated from participation as access to third-parties and aggregation of smaller contracts could be very beneficial to their operations, when managed properly, and consistent with safety and soundness.

State-Chartered Credit Unions

Federally-insured state-chartered credit unions (FISCUs) may have legal authority for derivatives activities based on state laws and regulations. We think NCUA's regulations should not seek to override such authority, absent material, demonstrable safety and soundness concerns. In the absence of state requirements, federally insured state chartered credit unions should be required to conduct their derivatives activities consistent with NCUA's regulation.

Mandatory Clearing

While there are benefits to mandatory clearing such as improved transparency, we do not think such requirements should be included in the regulation. If NCUA goes forward with this requirement, we would support an exemption or waiver process, including for smaller credit unions, to help mitigate compliance issues.

Accounting Issues

We are concerned with the accounting challenges reported by credit unions that currently engage in derivatives to hedge IRR. We encourage NCUA to work with credit union accountants, the CUNA CFO Council and CUNA's Accounting Subcommittee chaired by Scott Waite, to provide additional guidance to minimize the accounting impact and uncertainty on

credit unions that engage in derivatives, including guidance on Financial Accounting Standard 133.

Thank you for the opportunity to express our views on this advance notice of proposed rulemaking. We think the agency is generally pursing a beneficial course of action with this concept which if implemented, could help credit unions of all sizes mitigate their interest rate risks. If you have any questions about our letter, please do not hesitate to contact me, Counsel for Special Projects Kristina Sadlak, or Regulatory Counsel Dennis Tsang at (202) 508-6733.

Sincerely,

Mary Mitchell Dunn
CUNA Senior Vice President and Deputy General Counsel