



August 23, 2011

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

Dear Ms. Rupp:

On behalf of the partners of Wescom Credit Union, I am writing in response to the Advanced Notice of Proposed Rulemaking - Derivatives. Wescom Credit Union has been using derivatives in the Pilot Program since 2009. During a critical period when Wescom has worked diligently to preserve and restore capital, derivatives have been a vital tool in managing and hedging interest rate risk. We believe that derivative authority should be granted to individual credit unions and third party providers as long as certain qualifications are met.

Issues for Comment

A. Whether to discontinue allowing Pilot Programs for FCUs and third parties to engage in derivatives activities to offset IRR and, if so, whether to terminate such existing Pilot Programs

1. Should existing Pilot Programs for FCUs to engage in derivatives for IRR management be permitted to continue? Explain why or why not.

Yes. Credit unions should be allowed to use derivatives as an interest rate risk management tool under a Pilot Program or independently authorized by NCUA rules and regulations to permit credit unions to hedge on their own. The use of derivatives for hedging is considered standard practice for most banking institutions, and has allowed financial institutions and banks regulated by other Agencies to safely and efficiently manage their balance sheet to serve their customers without worrying about interest rate risk. Until a longer term solution from NCUA is in place, new third party providers should be allowed into the existing Pilot Program.

2. Should such Pilot Programs for FCUs be permitted to continue by "grandfathering" the previous approvals into Part 703? Explain why or why not.

Yes. We believe the existing Pilot Program should be grandfathered into Part 703 for current participants to ensure that current hedges outstanding are not interrupted. Current Pilot Program participants, such as Wescom, have spent a great deal of time and effort in meeting all NCUA guidelines and requirements and have demonstrated their experience with derivatives. Should there be additional requirements under the new guidelines, then NCUA should allow credit unions additional time to comply if independent authority is sought.

However, if credit unions continue using a Pilot Program provider or third party, then credit unions should be grandfathered.

3. *If FCUs seek an end-user exception from mandatory clearing as contemplated by the CFTC's proposed rule, they would need to provide items of information to a registered swap data repository. In view of this requirement, should NCUA permit FCUs to seek an end-user exception? Explain why or why not.*

- B. *Whether to allow FCUs to engage in such derivatives activities through a third party on a case-by-case basis (i.e., by waiver) provided the FCUs meet prudential standards applicable to the third party and the FCU;***
 1. *These third party standards would require replacement of credit quality references by functional equivalents. With this change, are the third party operating standards required in NCUA's Pilot Program generally appropriate to govern the use of derivatives by an FCU approved to engage in these activities through a third party? Explain why or why not.*

Credit Union Requirements

Financial Condition

We believe that NCUA should not require the credit union to have positive, stable earnings for the preceding 12 months. One quarter of negative earnings should not prohibit a credit union from hedging interest rate risk, especially at a time when hedging may be needed the most. Additionally the minimum 7 percent net worth ratio should be lowered to 6 percent (adequately capitalized), with NCUA approved exceptions on a case-by-case basis. Interest rate risk management should not be a function purely of earnings or financial strength, but based on the ability to fulfill contractually obligations.

In the case of Wescom where the net worth ratio has been below 6 percent in the past year, hedging using interest rate swaps has been the most effective and efficient interest rate risk tool as the balance sheet continues to deleverage.

Counter-party Credit Quality

All counter-parties must be AA- (or equivalent) or better at the time of any transaction. Termination of the transaction is required once a counter-party is downgraded to BBB (or equivalent). When there is a split rating, the lower rating will prevail.

In light of the S&P downgrade to US Treasuries and Government related debt, we believe that the minimum counterparty rating of AA- is too high as some banks and dealers may be subject to downgrades in the future. A minimum counterparty rating of A+ would be more practical to allow for more competitive pricing levels from additional dealers. Many of the Federal Home Loan Banks (FHLB) may potentially discontinue providing interest rate swaps and derivatives to Bank members due to increased regulations, which will further reduce competition in this space. If FHLBs continue to provide swaps to its members, then unilateral agreements should be allowed since FHLBs have not agreed to use bilateral agreements for credit unions. For non-rated financial institutions, such as Corporate Credit Unions or CUSOs, bilateral agreements should require collateral and maintenance margins to be posted to eliminate counterparty credit risk.

2. *If FCUs lacking prior experience with derivatives were required to spend a period of time within a third party Pilot Program, what period of time and/or number of transactions is reasonable to a safe and sound understanding of derivatives? In your answer explain why this is sufficient minimum time or number of transactions.*

We believe the ability to attain a safe and sound level of derivative understanding is a function of many factors and should not necessarily be governed by arbitrary time and volume guidelines. For example, credit unions that used a third party Pilot Program for 3 years and executed 5 transactions, may not have sufficient expertise, especially if there was personnel turnover at the credit union. Conversely, a credit union may have recently entered into the Pilot Program and executed zero transactions, but have a tremendous amount of expertise, analytics, and infrastructure. Guidelines to judge expertise and understanding should be function of expertise and understanding, and not a function of time and/or transaction volume.

C. *Whether to allow FCUs to independently engage in such derivatives activities by waiver provided they meet prudential standards*

1. *Should the NCUA Board consider allowing credit unions to engage in derivatives activity independently? Explain why or why not.*

Yes. Acting independently should be allowed as long as credit unions utilize derivatives only for hedging purposes to mitigate risk, and can demonstrate that it has the experience and expertise. At a minimum, credit unions will need to abide by comparable standards required by clients participating in the third party Pilot Program.

2. *What are the attendant criteria, such as, asset size, capital adequacy, the balance sheet composition of a credit union, or risk exposure with and without derivatives, that NCUA should take into consideration in evaluating an FCU's request for approval to engage in derivatives independently? Specify and explain any criteria that are essential.*

The critical attendant criterion is the experience of staff. We do not believe that asset size should be a factor as long as all derivative requirements are met. Also, we do not believe that balance sheet composition or risk exposure should be the determining factors for allowing independent derivative authority, and that NCUA should evaluate on a case by case basis if a credit union can use these tools in a safe and sound manner to manage interest rate risk.

3. *Are there specific actions an FCU should expect to take in preparation for applying to engage in derivatives activities independently? Specify and explain any actions which are needed.*

A credit union seeking independent authority should meet all standards as outlined in the third party provider program. The most important requirements are staff experience, board education, analytical modeling and pricing valuation.

A credit union should be able to demonstrate pricing of derivatives to independently value and verify mark-to-market values, and ensure best execution at the time of trade. Also, a credit union should have an in-house ALM model to show the impact of hedging on its risk position.

D. What approval standards should be established to govern the evaluation of an FCU's request for approval to engage in derivatives through a third party?

- 1. Should NCUA require an FCU to state a balance sheet management plan to hedge IRR based on risk management objectives as a condition for approval? Explain why or why not.*

No. We believe that having a balance sheet management plan should not be required. The existing guidelines for third party providers are sufficient as they require credit unions to examine both their current risk situation and the overall effects of any contemplated hedge prior to execution.

- 2. Is it useful for a FCU to rely on the expertise of a third party to assess the effectiveness of derivatives to hedge IRR on an ongoing and dynamic basis or should the FCU be required to demonstrate it has this expertise internally as a condition for approval? In either case explain why or why not.*

Yes. It is useful for a credit union to rely on the expertise of a third party to assess the effectiveness of derivatives to hedge IRR on an ongoing and dynamic basis. In most cases, it will only be viable for larger credit unions to have internal resources to use and manage derivatives without a third party. Regardless of whether or not the credit union utilizes a third party, the credit union should demonstrate a minimum level of expertise internally as a condition for approval.

- 3. Is it useful for an FCU to rely on the expertise of a third party to assess the credit quality of derivative counterparties? Explain why or why not.*

While it would be useful for a third party to assess counterparty risk, it would not be completely sufficient in mitigating credit exposure. To a certain extent, a credit union already relies on third party agencies to rate counterparties AA- or above. The uniform bilateral collateral and margin agreements are the primary factors in removing credit risk exposure.

E. What approval standards should be established to govern the evaluation of an FCUs request to engage in derivatives independently?

- 1. Should approval of an FCU to engage in derivatives activities be in the form of additional authorization similar to the expanded authority available under Appendix B to Part 704 – Expanded Authorities and Requirements? Explain why or why not.*
- 2. Should an FCU demonstrate enhanced credit functionality in terms of the experience of the FCU's personnel, credit analysis and reporting infrastructure in order to evaluate the creditworthiness of derivative counterparties? Explain why or why not and describe any minimum expectation.*

No. Enhanced credit functionality is not necessarily needed if credit risk is eliminated by fully collateralizing credit exposure. The credit risk of derivative trades will be dependent upon the governing ISDA agreements and Credit Support Annex. The required bilateral agreements will mitigate counterparty exposure.

3. *Should an FCU demonstrate enhanced hedging expertise based on the experience of FCU's personnel or on additional derivatives management infrastructure? Explain why or why not, and describe any minimum expectation.*

The experience of the credit union should not be limited to just employee experience but also should include access to system capabilities. Infrastructure should include ALM modeling, pricing systems (e.g. Bloomberg), and experience as well as derivatives trading experience.

4. *Is one year a sufficient amount of time for an FCU to fully prepare a self-assessment and application for approval to independently engage in derivatives to offset IRR? Explain why it is sufficient or why more time may be required*

It depends upon what type of experience the credit union has had over the period of one year. Some credit unions may acquire the skill and expertise to operate independently after one year, but some other may not.

5. *Are there any additional aspects of the FCU besides items (i)-(v) above which NCUA should consider in its approval for the FCU to engage in derivatives activity independently? If so, explain why the item should be considered.*

Thank you for the opportunity to respond to this request and provide comments.

Sincerely,



Irving Yu
VP/Treasury
Wescom Credit Union