California CREDIT UNION LEAGUE NEVADA CREDIT UNION LEAGUE

Filed via: regcomments@ncua.gov

August 17, 2011

Ms. Mary Rupp
Secretary to the Board
National Credit union Administration
1775 Duke Street
Alexandria, VA 22314

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

Dear Ms. Rupp:

On behalf of the California and Nevada Credit Union Leagues, I appreciate the opportunity to comment on the Advance Notice of Proposed Rulemaking (ANPR) on whether and how to modify its investments rule to permit a natural person Federal credit union to engage in the purchase and sale of financial derivatives for the purpose of offsetting interest rate risk. By way of background, the California and Nevada Credit Union Leagues (Leagues) are the largest state trade associations for credit unions in the United States, representing the interests of more than 400 credit unions and their 10 million members.

Background
NCUA currently allows a limited number of Federal credit unions, on a case-by-case basis, to engage in derivatives through an investment pilot program. The program allows some derivatives activities that would otherwise be prohibited by Part 703 (Investments and Deposit Activities). Since 1998, NCUA has approved three third-party entities under the pilot program – Western Corporate Federal Credit Union, ALM First Financial Advisors, and Southwest Corporate Investment Services. In addition, NCUA has approved two Federal credit unions under the program to each independently engage in derivatives activities for interest rate risk purposes on its own behalf. It is our understanding that one of those credit unions is ESL Federal Credit Union in Rochester, New York. The other is Chevron Federal Credit Union in Oakland, California. Chevron Federal Credit Union has been a participant in in the pilot program since 1998.

NCUA seeks comment on the following policy alternatives:

- Whether to discontinue allowing the investment pilot programs for Federal credit unions and third parties to engage in derivatives to offset interest rate risk and, if so, whether to terminate such existing pilot programs;

- Whether to allow Federal credit unions that meet prudential standards to engage in derivatives on a case-by-case basis through a third party and/or independently; and

- What approval standards should be established to evaluate a Federal credit union's request to engage in derivatives through a third party and/or independently.

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Existing Pilot Programs
As NCUA is aware, there is a significant distinction between the derivatives instruments that helped fuel the subprime mortgage meltdown (e.g., credit default swaps) and the types of derivatives transactions permitted under the pilot program (i.e., interest rate swaps and caps). Interest rate swaps and caps have a proven track record, and the risks and costs are well-defined. While the Leagues recognize that the use of derivatives may not be appropriate or appealing to all credit unions, we believe that they are a potentially valuable tool for managing interest rate risk when used properly. Chevron Federal Credit Union has reported to us that the use of hedging activities has enabled them to effectively meet the real estate borrowing needs of their members, while significantly enhancing their return on assets and maintaining robust net economic value in interest rate shock scenarios.

In fact, the ANPR cites no rationale or analysis for discontinuing the pilot program. We do understand and agree with NCUA's position that Federal credit unions should not be permitted to engage in derivatives activities unconditionally. However, the pilot program permits nothing of the sort, containing substantial provisions regarding a credit union's financial condition, accounting standards, investment limitations, and required procedures and controls. The Leagues strongly disagree with discontinuing a long-time program that does not appear to present significant risks to its participants, and helps to address NCUA's concerns regarding upward interest rate movement. Therefore, unless NCUA decides to allow Federal credit unions to engage in derivatives through a third party and/or independently as a permissible activity (discussed below), we urge NCUA to not discontinue the existing pilot programs.

Third Party/Independent Derivative Authorization
The Leagues support allowing Federal credit unions that meet prudential standards to engage in derivatives on a case-by-case basis through a third party and/or independently as a permissible activity. This would not only be in agreement with the Federal Credit Union Act—which recognizes financial derivatives as an "incidental power" for federally-chartered credit unions (12 U.S.C. 1757(17))—but would also provide credit unions with an equal footing within the financial industry. Financial institution balance sheets are typically comprised of long duration assets funded by short duration liabilities. Banks have access to derivatives to help them manage their risks; restricting access to these instruments for credit unions places them at a competitive disadvantage.

In general, we believe that the standards used under the current pilot program are appropriate for use with both third party and independent derivative activities. Whether managed internally or through a third party, we believe that credit unions should demonstrate a minimum understanding of the risks associated with a derivatives program, and should possess the necessary analytical skills to manage it. However, we do urge NCUA to review concerns about the standards voiced by Chevron Federal Credit Union in their comments to NCUA regarding; 1) qualifying for the effectiveness requirements under FAS 133 (Hedge Accounting Requirements); 2) the requirement to terminate transactions in the event a counterparty is downgraded to BBB or equivalent; and 3) the counterparty requirement of a minimum AA- rating.

Approval Standards
We agree with NCUA that credit unions seeking to engage in derivatives activity must demonstrate adequate expertise and infrastructure to do so, and that those seeking to do so independently would require extensive examination at application, as well as enhanced supervision once the program was operational. Finally, while we understand that asset size may play a factor in a credit union's ability to start up and manage a derivatives program, we do not believe that it should be an excluding factor.

Thank you for your consideration of our comments and concerns. We look forward to working with NCUA in shaping a rule that effectively balances the need to provide credit unions tools for managing interest rate risk with the need to maintain safe and sound programs.

Sincerely,

Diana R. Dykstra
President/CEO