March 29, 2012

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

Re: 12 CFR Part 703, Financial Derivatives Transactions to Offset Interest Rate Risk

I would like to express my appreciation to NCUA for considering this important topic. One of NCUA's greatest concerns for credit unions over the next few years as mentioned by the Board remains exposure to interest rate risk. One of the easiest, low cost and low risk ways to management interest rate risk without significantly impacting the size of the balance sheet and net worth ratio is the use of interest rate derivatives.

The current structure that requires a credit union to seek approval to be part of a pilot program by NCUA has prevented many federally chartered credit unions including OSU Federal from using even simple interest rate swaps. We would like to be able to have access to derivatives to help in the management of interest rate risk. Having access to derivatives such as this would have been a huge benefit to our credit union during the last four years, allowing us to offer lower rate consumer loans and swapping that low rate into a variable income stream as rates rise. This would have cut our interest rate risk exposure and help keep us competitive with both state chartered credit unions and banks. The limited documentation, limited pilot partners and the burden of seeking approval for even third party administered, simple derivates kept us from using this tool. In general, NCUA should embrace ways by which federally chartered credit unions can utilize derivatives including reducing the burden of seeking approval through a process which currently has limited documentation.

The decision of determining the risk appetite and the establishment of the policy limits should be left to the credit union's board of directors. It would be important to OSU Federal to be able to structure a program that fits our needs today and also allows the credit union to explore what would be affective as we grow. We think it's important for NCUA to create flexibility within the regulation to allow credit unions to manage their risk in line with their unique structures rather than dictate narrow limits. The effectiveness and thoroughness of the derivative program can be reviewed as part of the routine exam process.

If NCUA eventually comes to the conclusion that independent authority requires regulatory approval, then credit unions who want to use derivatives with the assistance of a third party should be granted authority by NCUA without additional approval requirements. Also, clear, detailed information about seeking approval for independent authority should be provided. NCUA should not place road blocks in the way of interest rate derivative use.

Should the Board require an FCU to demonstrate a material IRR exposure or another evident risk management need before it is granted independent derivatives authority?

We strongly believe that the board of directors should be the guiding source for determining whether a credit union should employ interest rate derivatives to better manage interest rate risk or offset new risks being built into the balance sheet. The right time to place derivatives onto a balance sheet is when the credit union is offering products that they know will inherently affect their interest rate position. By incorporating the derivatives as they offer the product, they are proactively managing their risk. What is prudent about waiting until there is a material IRR exposure before seeking to manage it with derivatives? If NCUA requires that a credit union demonstrates a material IRR exposure, then it might be too late to put a low cost derivative plan into place.

Is it appropriate to require minimum performance levels, as measured, for example, by CAMEL ratings and net worth classifications, when considering whether to grant or deny an FCU's application to independently engage in derivatives transactions? If so, what performance measures are appropriate and what should those levels be?

If there are low cost, low risk ways to mitigate the impact of interest rate risk on the future earnings and net worth of a credit union, why limit these options only to already high performing credit unions as evidenced by a CAMEL rating. There may be times when the use of an interest rate swap may be a great tool for a credit union that is suffering from a lower capital position or a difficult financial situation. It doesn't make sense to limit the tools available.

What is the minimum kind and amount of derivatives experience and expertise that an FCU's staff should demonstrate before the FCU receives independent derivatives authority? For example, if an FCU has a less complex balance sheet, is it sufficient for the FCU's staff to demonstrate a minimum of three years transacting derivatives? Should NCUA require additional kinds and amounts of experience when there is more complexity in the FCU's balance sheet (e.g., prepayments and call options)?

The level of experience should be tied to the types of derivatives that the credit union has laid out in their board approved policies. Many simple interest rate swaps are not complex. In fact no more complex than many loans and investments already on the credit unions balance sheet. The standards for these types of derivatives should be less burdensome than suggested in the proposed rule.

To what extent should an FCU seeking independent derivatives authority be allowed to rely on an outside party to fulfill an experience and expertise requirement?

A credit union should be able to utilize an independent derivatives authority to fulfill an experience and expertise requirement. Again, the use of derivatives to manage interest rate risk is a readily available and well used tool to manage risk throughout the financial industry. Additional roadblocks to the use of this tool would limit many credit unions, including OSU Federal from taking advantage of interest rate derivatives.

Should FCUs be limited to using interest rate swaps and interest rate caps to offset and manage IRR? Should interest rate swaps be limited to pay-fixed/receive-floating instruments? What other limits should be established to ensure that an FCU does not transact interest rate derivatives in an amount greater than the level of its IRR exposure?

Since credit unions differ in size and complexity, the need for derivatives to manage interest rate risk will differ as well. Access to derivatives as an effective interest rate risk tool should not be limited to only swaps and caps when other products may be more efficient. The individual credit union board should establish the types of derivatives the credit union utilizes.

Limits places on the type of swaps that can be used such as "pay-fixed/receive floating" assumes that we will remain in a low interest rate environment. Regulatory guidance should not dictate limits on the specific components of a derivative plan, but review the management process that the credit union has put into place.

Since the calculation of interest rate risk exposure is an ever changing estimate reached through ongoing analysis, it would be difficult to define and measure a credit union's compliance with this concept if included in the regulation. The credit union should establish policies and guidelines on how to manage the level of derivatives to the interest rate risk exposure.

Should NCUA establish exposure limits for FCUs or should it require an FCU's board of directors to establish exposure limits? Should there be limits on the aggregate amount of each type of derivatives instrument in the portfolio or on the aggregate amount of derivatives transacted with any counterparty? Should limits be based on the notional amount of a derivatives instrument, its mark-to-market valuation, or both?

A credit union board of directors should be responsible to establish the exposure limits for the credit union. These limits may include exposure by type of derivative. Diversification of counterparties may be appropriate so long as there are a variety of strong counterparties in the market available to a credit union. Otherwise, forced diversification can push a credit union to utilize riskier counterparties. Fair market valuation which represents the current exposure to the credit union seems like an appropriate measure for derivatives.

Are there ways to mitigate counterparty risk besides posting collateral? Are there additional or alternate collateralization conditions that NCUA should require beyond those described in this ANPR?

Collateral may be the easiest way to mitigate counterparty risk. It would seem appropriate to also be able to utilize a letter of credit as a substitute for physical collateral. Many states allow credit unions to use a letter of credit from the Federal Home Loan Bank to collateralize deposits of public funds above insured limits. This option might be easier for credit unions to implement.

Again, thank you for bringing this proposed rule forward for comment.

Sincerely,

Bonnie Humphrey-Anderson
Executive Vice President/Chief Financial Officer