CommunityAmerica®
CREDIT UNION

March 29, 2012

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

Dear Ms. Rupp:

Thank you for the opportunity to respond to the Advanced Notice of Part 703 – Financial Derivatives Transactions To Offset Interest Rate Risk; Investment and Deposit Activities.

Questions for Comment

A. ***Eligibility of Applicant FCUs for Independent Derivatives Authority***

1. *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?*

   The granting of authority should be based on the credit unions ability to manage the process. Independent derivatives authority should be viewed as an additional tool available to competent practitioners to be used in the best interest of their institutions.

   Upon receiving authority, the credit union should at a minimum be able to document the rationale for each trade. IRR must be mitigated. Before and after NEV shocks should be documented and approved by the institution with attached detailed assumptions retained for the life of the trade. Given the range of historical interest rates on both ends of the yield curve, it is difficult to envision a circumstance where a credit union could not demonstrate a material IRR exposure.

2. *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?*

   The issue is interest rate risk. A demonstrated history of successful IRR/NEV management should be required. Independent authority is not intended for credit unions that find themselves at risk due to on-going mis-management of interest rate risk. Those credit unions should be directed to third-party providers such as ALM First. Additionally, FCUs with quality interest rate risk management programs should not be penalized for underperformance in other areas of their institution (credit) or strategic initiatives (mergers) which could ultimately increase the overall interest rate risk position of the credit union. Independent authority should be reserved for institutions that have demonstrated the ability to manage interest rate risk over an extended period of time that are looking to enhance their on-going strategy or reduce cost.

3. *What is the minimum kind and amount of derivatives experience and expertise that an FCU 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 that 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)? 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?*

   FCUs seeking independent authority should either be transitioning from a successful third-party (pilot program) relationship, or employ experienced practitioners seeking new authority. In either case FCUs should have long standing relationships transacting a variety of securities with eligible broker-dealers. It is unreasonable to expect low transaction cost on a one-off trade that will likely be small by street standards. FCUs should attempt to have multiple dealer relationships to create a competitive marketplace for derivatives trades.

   Experience is too subjective to quantify. NCUA should establish a vetting process designed to determine eligibility. The process could include questionnaires, interviews, conference calls etc.

   Outside parties should only be allowed to fulfill back-office functions such as accounting or ALM modeling. All trade/hedge related decision-making should reside within the institution.

B. Safety and Soundness Requirements

4. *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 if its IRR exposure?*

   Upon being granted independent authority, trades should be established based on a pre-determined IRR/NEV strategy. For accounting purposes, specific assets or liabilities are designated. However, a key advantage of using derivatives to hedge is flexibility. As the underlying fundamentals of the hedge change, affordable re-balancing is an option. This is not the case with FHLB advances.

   The agency should look into the availability and affordability of sophisticated modeling. Convexity of assets or liabilities being hedged and related gammas, deltas and thetas of derivatives used for hedging may be desirable. Plain-vanilla swaps may be effective at hedging non-maturity deposits but much less so when used to hedge long-term fixed rate mortgages. When dealing with options either embedded, or stand alone in the case of caps, a basic understanding of greeks is desirable.

   Credit derivatives should not be allowed at this time.

5. *Should NCUA establish exposure limits for FCUs or should it require an FCU's board 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?*

   The FCUs Board should establish exposure limits via the policy revision / creation process. NCUA can review exposure limits as part of the FCUs annual examination.

   Institutions should employ strategies using the amount of instruments necessary to be effective in mitigating the exposed interest rate risk and should not be constrained by regulation. Mark-to-market valuation as a measure of hedge effectiveness should be reviewed monthly by the institutions ALCO and reported to the Board. Hedge effectiveness limits should be pre-established by internal policy with corrective actions defined should limits be violated. This is consistent with FAS 133 hedge accounting treatment which requires a test of hedge effectiveness.

   As mentioned above, the credit union should seek to establish a competitive market for derivative transactions. FCUs with independent authority should always be looking to deepen the market for derivatives transactions which if done correctly will lead to diversified counter-party exposure. It is still to be determined if OTC derivatives will be exchange traded as mandated under Dodd-Frank.

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

   We agree with the agency's assessment of the need for collateral management standards. The ability to move transactions to regulated exchanges does not exist today, but may ultimately change the counter-party / margining risk dynamic.

   Additionally, the agency should examine the use of ratings solely as criteria for counter-party approval. Many dealers with ratings that fall slightly below current regulatory requirements post cash collateral on a daily basis to facilitate the business. In some cases this could be preferential to higher rated dealers posting securities less frequently.

We hope you find these suggestions useful and welcome any future dialogue.

Sincerely,

Tim Saracini

Tim Saracini
Senior Vice President – Finance Services
CommunityAmerica Credit Union
Lenexa, KS