



Credit Union National Association

[cuna.org](http://cuna.org)

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April 3, 2012

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

Re: Financial Derivatives Transactions to Offset Interest Rate Risk;  
Investment and Deposit Activities, Part 703

Dear Ms. Rupp:

This comment letter represents the views of the Credit Union National Association (CUNA) regarding the National Credit Union Administration's (NCUA's) advance notice of proposed rulemaking (ANPR) on the eligibility of federal credit unions (FCUs) for independent derivatives authority without program oversight by a third-party provider. 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 94.5 million members.

We commend NCUA for continuing a rulemaking process regarding the limited use of derivatives within natural person credit unions to help manage their risks associated with rising interest rates.

Currently, NCUA permits a limited number of FCUs, on a case-by-case basis, to engage in some derivatives transactions to hedge IRR through an investment pilot program. In 2011, six FCUs participated in the pilot program through a third-party provider and two FCUs have independent authority.

In our view, state as well as federally chartered credit unions should be able to engage in derivatives as a permissible investment activity in order to manage interest rate risk (IRR).

CUNA also supports derivatives authority through a third-party for well-managed credit unions and independent authority for certain credit unions with adequate derivatives experience. Further, credit unions that currently have independent authority under the existing investment pilot program should be grandfathered and continue to have independent authority. The use of derivatives in a limited and prudent manner will allow credit unions



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to maintain margins on their fixed-rate loan portfolios and thus, facilitate their ability to continue making loans to their members.

Our members agree that derivatives activities at participating credit unions should be subject to meaningful but not overly burdensome qualifications. Credit unions that receive independent authority should demonstrate an existing or forecasted IRR exposure that can be reduced by the use of derivatives. Also, credit unions should demonstrate a requisite level of financial performance. In addition, while participating credit unions should have staff with adequate experience in all facets of their operations, the rule should not include an experience requirement based on a specific number of years, as credit unions should be able to set such criteria for themselves, based on the nature and level of their derivatives activities.

CUNA agrees the sound management of derivatives activities requires appropriate vigilance and supervision on the part of the credit union. A participating credit union's board should understand, set the parameters of, and monitor the derivatives program and risk management policy, but a credit union board should not have to approve each transaction in its day-to-day operations. In addition, a FCU should be able to oversee and use a third-party to meet certain types of derivatives experience and expertise.

### **Types of Derivatives**

Regarding the types of permissible derivatives, a credit union with independent authority should be permitted to use basic interest rate swaps to hedge IRR. For example, interest rate swaps that are pay-fixed/receive-floating instruments would offset the credit union's balance sheet since floating rates would be paid on shares and payments with fixed rates would be received from mortgages and loans. Interest rate caps can also be used by credit unions to hedge IRR. In addition, certain other types of derivatives to hedge IRR may be appropriate for well-managed credit unions as long as they comply with any counterparty requirements, as applicable, as addressed in a regulation.

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.

### **Potential Exposure Limits**

The credit union's board should establish exposure limits on derivatives, which should be based on its IRR exposure and the risk management

needs of the credit union. However, we do not support limits on the aggregate amount of each type of derivatives instrument in the portfolio because credit unions will have varying needs regarding the types of derivatives they will use. Also, there should not be a limit on the aggregate amount of derivatives with any one counterparty because such limits may reduce access to derivatives given the current limited number of eligible counterparties.

Regarding potential regulatory exposure limits, we believe NCUA should consider both the changes in the value of the derivatives and the underlying asset or liability the derivative has hedged. We are concerned that an exposure limit based on the derivatives position by itself would not account for the effectiveness of the IRR hedge.

If NCUA must establish limits based on the value of the derivatives position by itself, a single limit based on mark-to-market values could be useful but still would not account for changes with the underlying asset or liability.

### **Counterparty Risk**

The existing pilot program currently specifies certain collateral requirements to help mitigate counterparty risk. NCUA should not impose stringent requirements on collateral that would decrease the number of permissible counterparties. While there should be appropriate standards for counterparties, including with collateral, there should be sufficient flexibility to allow a greater number of eligible counterparties, which may lead to access to different products and more competitive pricing.

Thank you for the opportunity to comment on this ANPR. If you have any questions concerning our letter, please feel free to contact me or Regulatory Counsel Dennis Tsang at (202) 508-6733.

Sincerely,

A handwritten signature in cursive script that reads "Mary Mitchell Dunn".

Mary Mitchell Dunn  
CUNA Senior Vice President and Deputy General Counsel