SACU

6061 IH-10 West
P. O. Box 1356
San Antonio, Texas 78295-1356
210.258.1414 1.800.234.SACU
sacu.com

April 3, 2012

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

Subject: PART 2, Comments on 12 CFR Part 703 ANPR, Financial Derivatives Transactions to Offset Interest Rate Risk; Investment and Deposit Activities.

Dear Ms. Rupp:

On behalf of San Antonio Credit Union, I am writing in response to the Advanced Notice of Proposed Rulemaking – Derivatives.

Question 1: Should the Board require an FCU to demonstrate a material IRR exposure or another equivalent risk management need before it is granted independent derivative authority?

Answer: No. We believe the focus should be on the credit unions' intent to manage interest rate risk, rather than require credit unions to prove a current material level of exposure. Credit unions should seek approval for derivate authority well in advance of the need to hedge the risk. The reason, under the past third party pilot programs, the time frame to apply and gain approval for derivative authority was in the 12 – 24 month range. Waiting to add this "tool" to the toolbox once interest rate risk exposure is prevalent could create an environment where proper education and experience are not fully developed.

Question 2: Is it appropriate to require minimum performance levels as measured, for example, by CAMEL ratings and net worth classification, when considering whether to grant or deny an FCU's application to independently engage in derivatives transaction? If so, what performance measures are appropriate and what should those levels be?

Answer: Yes. We recommend a minimum net worth requirement of 6% provided exceptions are considered on a case by case basis. Situations will arise where credit unions with less favorable financial positions would benefit by being allowed to mitigate potentially dangerous interest rate risk through the use of derivates.

Question3: What is the minimum kind and amount of derivatives experience and expertise that an FCU's staff should demonstrate before the FCU receives independent 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?

- Answer: 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. Guidelines to judge expertise and understanding should be a function of expertise and understanding, not numeric targets. Credit unions seeking independent authority should demonstrate an advanced level of skills prior to being approved for independent authority. The NCUA should develop a process whereby they can properly asses a credit unions' understanding of the various risks associated with using derivatives. This should include a strong understanding of the derivative contracts (ISDA, Credit Support Annex), trade execution, valuation and hedge accounting.

Question 4: Should FCU's 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?

Answer: Yes, we believe that the current list of products should initially be limited to the following plain vanilla interest rate derivatives and there allowable use should only be to hedge and manage IRR:

- Pay fixed – Receive floating
- Receive fixed – Pay floating
- Pay floating – Receive floating (referred to as a basis swap, where and when it makes sense).
- Caps and floors.

Limiting credit unions to hedge transactions that reduce NEV risk is a means to ensure credit unions are focusing on reducing existing interest rate risk exposure and not as a means to lock in an alternative source of cheap funding. The proposed limit should be on the execution of a specific transaction and not prevent the approval of derivative authority.

Question 5: Should NCUA establish exposure limits for FCU's 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?

Answer: Limits, if imposed, should be based on mark-to-market, not on outstanding notionals. Overall risk, collateral thresholds and accounting gain/loss is driven by the MTM not the notional. However, an unintended consequence to imposing dollar based limits, could cause credit unions to unwind positions that are still effective and make sense in terms of reducing interest rate risk.

Credit unions' board of directors should define appropriate mark to market limits for the use of derivates. Provided hedging positions are fully collateralized with an initial maintenance margin as well as their current MTM, there is no reason to limit the number of trades executed with an individual counterparty.

Question 6: 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?

Answer: In the absence of all trades moving to a universal exchange or clearing house that guarantees fulfillment of all transactions, the best way to mitigate credit risk is the full collateralization (maintenance and MTM) and dynamic monitoring of the hedge positions.