



# New England Federal Credit Union

July 24, 2013

Ms. Mary Rupp  
Secretary of the Board  
NCUA  
1775 Duke Street  
Alexandria, VA 22314-3428

RE: Comments on Advance Notice of Proposed Rulemaking for Part 703, Financial Derivatives Transactions to Offset Interest Rate Risk

Dear Ms. Rupp:

Thank you for the opportunity to comment on the proposed rule for derivatives. As a credit union that is fast approaching \$1B in assets, it is critical to expand the types of tools that are available to us to manage interest rate risk. As such, we are very invested in a new rule that allows the responsible and prudent use of interest rate derivatives for credit unions. While we are encouraged that the NCUA has embraced the concept of credit unions using these tools, we believe there are some limitations in the proposed rules that could compromise their effectiveness.

## **Application Fees**

Perhaps the most controversial aspect of the ANPR is the proposed application fee. We recognize that there will need to be prudent resources assigned by the NCUA to oversee the use of derivatives by credit unions. However, the same could be true of other types of products and services currently offered at credit unions such as business lending or insurance services. There appears to be no precedence for the regulator to charge a credit union for the ability to engage in prudent risk management practices. Furthermore, it could be argued that the cost of regulatory oversight has been borne mostly by larger credit unions while the use of regulatory oversight, has been concentrated in smaller credit unions. The number of exam hours is disproportionately weighted toward smaller credit unions, while the larger credit unions pay more in annual fees. We recommend that the oversight costs be treated like all other costs to the credit union industry – via the NCUA's annual budget.

## **Permissible Derivative Transactions**

We recommend that the NCUA expand the rule to allow the use of interest rate floors as well as swaps and caps. The rule should not be biased toward any given future rate environment. We have seen an extraordinarily long period of low rates. Many credit unions, like ours, have experienced a declining margin as a result. By their very nature, credit unions face a real challenge to their cooperative charter when rates get this low. Many have been reluctant to reduce deposit rates to what would be considered a "market rate." Credit unions need to serve their members through all different interest rate environments and interest rate floors can help them achieve that.

### **Maximum Permissible Maturity Restrictions**

The maximum and average life restrictions are concerning to us as well. Many credit unions have access to longer term real estate loans and, given declining loan to deposit ratios, there is a lot of interest in booking these mortgages. However, well managed credit unions understand the risk of booking longer term mortgages and have avoided adding the interest rate risk. Having access to longer term derivative transactions will enable credit unions to increase their profitability while protecting themselves from increased interest rate risk. We believe these restrictions should be increased to at least 15 years.

### **Qualified Derivatives Personnel**

Under the previous Pilot program, it is our understanding that the credit unions that were given authority to engage in derivatives were required to work with an NCUA approved advisor. We are concerned that the proposed rule appears to ignore this method as a valid means for a credit union to gain access to advisors with derivatives transaction experience. The proposed rule requires that a credit union, depending on the level of authority requested, must have personnel with between 3 and 5 years of direct transactional experience in derivatives. This effectively disqualifies most credit unions that might be considering these valuable ALM tools. For a credit union to hire such an experienced person, the cost would most certainly exceed what it would take to engage an experienced advisor. It's hard to envision a scenario where an individual credit union, that already has competent financial management in place, would have enough work to keep a new employee engaged with a limited number of derivatives transactions. The cost of hiring and carrying such personnel would detract from the value of the derivatives transaction, essentially resulting in a permanent cost for an infrequent activity.

### **Internal Controls Review**

The requirement to have an annual internal controls audit seems onerous and rather expensive. Raising the requirement to the level of an independent audit would set this type of activity apart from other, more complex, activities in which credit unions regularly engage and for which there is no such requirement. We do support the idea of having internal controls reviewed. This review could be done by an internal auditor or as a separate engagement with an external auditor.

Thank you for considering our comments on the proposed rule for derivatives. We believe derivative transactions are important to the future of the credit union industry and will add to our capacity to manage the balance sheet in a safe and sound manner.

Sincerely,



Susan E. Leonard  
Sr. Vice President/Chief Financial Officer