IDAHO
DEPARTMENT OF FINANCE

C.L. "BUTCH" OTTER
Governor

GAVIN M. GEE
Director

July 29, 2013

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

Via Email to regcomments@ncua.gov

Re: Idaho Department of Finance Comments on Proposed Rulemaking for Parts 703, 715, and 741

Dear Ms. Rupp:

The Idaho Department of Finance (Department) appreciates the opportunity to comment on NCUA's Proposed Rulemaking for Parts 703, 715, and 741 (proposed rule). The Department regulates all state-chartered financial service providers in Idaho except for the insurance industry; this includes the regulation of banks, their holding companies, and 32 state-chartered credit unions. We understand the need for financial institution regulators to closely monitor and if necessary, restrict the derivatives activities of credit unions. Nevertheless, we are opposed to many aspects of the proposed rule. The Department strongly supports the National Association of State Credit Union Supervisors (NASCUS) comment letter and will not seek to repeat in detail the points ably made within that letter.

We believe the proposed rule represents an unwarranted preemption of the power of state-chartered credit union supervisors to oversee credit exposure of their federally insured state-chartered credit unions (FISCUs); the proposed rule imposes unreasonable and excess regulatory burdens, including unprecedented "pay-to-play" fees; and the proposed rule arbitrarily prohibits some credit unions from engaging in derivatives transactions based on asset size. The consequence of the rule may well be that capable credit unions will choose not to employ interest rate swaps and caps, due to the unnecessary and costly requirements of the rule.

The NCUA has only recently stated its intention to apply these rules to FISCUs. As a consequence of this timing, as compared to the comment opportunity afforded federal credit unions, state regulators and FISCUs have been afforded only a relatively brief period to analyze the NCUA's complex derivatives rule and submit comments on it. FISCUs and their state regulators should be allowed a greater period of time to properly analyze and submit comments on the proposed rule.

There is an aspect of the proposed rule which is confusing and which will create doubt as to whether any FISCUs in some states will be authorized to engage in derivatives transactions. The proposed rule, at 12 CFR § 703.100(a), would apply to federal credit unions and FISCUs "that are permitted to engage in derivatives transactions under applicable state law." However, the NCUA's supplementary information accompanying the proposed rule, with respect to the rule's application, provides that the rule applies to FISCUs "that are *expressly* permitted by applicable state law to engage in derivatives transactions (italics added)." As in many states, Idaho law does not *expressly* permit state-chartered credit unions to engage in derivatives transactions. However, we believe derivatives transactions are of the type of transactions Idaho credit unions may engage in under the Idaho Credit Union Act and the Department would regulate them accordingly. At the minimum, this point should be clarified in the NCUA's final rule.

We start with the premise that basic interest rate swaps and interest rate caps are tools that have historically been used by financial institutions to mitigate interest rate risk, and we want to encourage credit unions that are capable of responsibly engaging in these derivative transactions to use all tools available to manage that risk. As interest rate risk looms in the credit union industry, we are concerned that the proposed rule, although drafted with the purpose to limit risk inherent in the use of derivatives, will have the unintended consequence of increasing risk to credit unions by effectively denying them the use of basic derivative transactions.

A. State Credit Union Regulators Should Remain the Agencies Authorized to Oversee the Derivatives Activities of FISCUs

As in other states, the Department has the statutory authority to regulate and restrict any transactions its chartered credit unions engage in that create credit exposure in those credit unions. Idaho Code §§ 26-2140 and 26-2144. Under the Idaho Credit Union Act, the Department can also grant state-chartered credit unions the authority to engage in derivative transactions to the same extent as a federal credit union or a credit union chartered by another state. Idaho Code § 26-2145. When the Department grants parity authority to an Idaho state-chartered credit union, it requires the credit union to comply with all of the rules and restrictions placed on the activity by either the NCUA or the state law which will be looked to in a given case. In its proposed rule, the NCUA has suggested that "unregulated use of derivatives poses significant risk to the National Credit Union Share Insurance Fund (NCUSIF)." In Idaho, and we suspect in most other states, the use of derivative transactions by FISCUs is not unregulated.

With respect to Idaho state-chartered banks, § 611 of the Dodd-Frank Act (12 USC § 1828) effectively prohibits state-chartered banks from engaging in derivatives transactions unless the law of the state where the bank is chartered "takes into consideration credit exposure to derivative transactions." The Dodd-Frank Act does not dictate the manner in which state agencies will regulate derivative transaction activities of state-chartered banks. The Act also does not contain a similar requirement regarding credit unions.

When Congress enacted § 611 of the Dodd-Frank Act, it recognized that overseeing the credit exposure of state-chartered banks is the province of those banks' chartering authorities. There is no reason to believe Congress views the matter differently with respect to FISCUs. In the case of the Federal Deposit Insurance Fund, even though it is charged with protecting that fund, the

FDIC has not found it appropriate to displace state regulation and enact a detailed and complex regulatory scheme for derivative transactions.

Both prior to the enactment of the Dodd-Frank Act and subsequent thereto, the Department has regulated the derivative transactions Idaho state-chartered banks engage in. Prior to the proposed regulation, the NCUA prohibited federal credit unions from engaging in derivatives transactions. Consequently, the NCUA has not been burdened with the task of oversight in this area. The NCUA has not demonstrated that states' oversight of FISCUs' derivatives activity is deficient. Despite this history, through the proposed derivatives rule, the NCUA would displace the states' oversight of FISCUs' derivatives activities and assume that responsibility. Further, the NCUA would assess burdensome and unrealistic fees to FISCUs to recoup the NCUA's additional costs incurred in its unnecessary assumption of the states' role in supervising FISCUs' derivative transactions. This action is unwarranted.

Despite the absence of federal statutory authority on the subject, or evidence that derivatives transactions by FISCUs has created a threat to the National Credit Union Share Insurance Fund, the NCUA states that the rule applies to all FISCUs that are permitted by applicable state law to engage in derivatives transactions. The investment powers of state-chartered credit unions and banks have historically been the province of the state agencies. The Department urges the NCUA to eliminate FISCUs from the coverage of the proposed rule.

B. Unreasonable Regulatory Burden

The proposed rule, as a whole, contains a level of detail and complexity which goes beyond the need to ensure that credit unions stay within the boundaries of safety and soundness in engaging in the most basic types of derivatives transactions. We support a careful approach to implementing prudential safeguards for credit unions that desire to engage in basic derivatives transactions. However, many credit unions that have an appropriate level of staff experience and skill to engage in basic derivatives transactions will likely be dissuaded from engaging in these transactions, which may benefit them, due to the additional staffing and other costs entailed in complying with the proposed rule. We provide three examples:

1. Proposed Application Fees

In an unprecedented "pay-to-play" proposal, NCUA will assess credit unions an application fee starting at $25,000 for credit unions desiring to engage in Level I activity and between $75,000 to $125,000 for credit unions desiring to engage in Level II activity. These sums are cost prohibitive and will ensure that only a small number of credit unions will engage in basic derivatives transactions. At page 32205 of 78 F.R., the NCUA estimates that 150 credit unions will apply for and be granted derivatives authority. It is difficult to imagine that only 150 credit unions would benefit from the ability to engage in basic derivatives transactions and that only 150 credit unions have personnel with the knowledge and experience to engage in the activity.

To the extent that many credit unions could meet the criteria for either Level I or Level II activity, many of those credit unions may conclude that the proposed "pay-to-play" fee will not be recouped by the financial benefits obtained in basic derivatives transactions. The Department is opposed to the concept that financial institutions should be charged special fees by regulators to implement risk mitigation measures.

2. Experience of Counsel

Another unprecedented requirement is that a credit union must obtain a legal opinion from "qualified counsel" before executing any derivatives transaction. Qualified counsel means an attorney with at least five years' experience reviewing derivatives transactions. Among other conclusions that are required from the attorney, counsel must find that the credit union is in compliance with the regulation. It seems a clear overreach of authority for NCUA to attempt to dictate specific experience requirements of a credit union's counsel, and will result in unnecessary expense to the credit union.

3. Direct Transactional Experience of Staff

In addition to requirements that the board of directors receive training before a credit union enters into derivative transactions, and annually thereafter, and that senior executives be evaluated by NCUA regarding education, skills, and experience related to derivatives, the proposed rule requires that employees responsible for day-to-day related activity have three years' experience for Level I authority, and five years' experience for Level II. To satisfy the requirement, the experience must be "direct transactional experience" in trading, structuring, analyzing, monitoring, or auditing derivative transactions. It is unlikely that credit unions currently have employees who meet the requirements. Additional staff would therefore need to be hired, further increasing costs associated with meeting the burdens of this rule and the likelihood that credit unions will be dissuaded from this activity. Also, it is not clear that such level of direct experience among staff is necessary for basic interest rate swaps and caps.

C. Arbitrary Asset Level

Given the many requirements credit unions wishing to engage in derivatives transactions would need to meet, any minimum required asset amount appears arbitrary. The rule proposes an asset threshold of $250 million. There is no support provided for the notion that a $240 million credit union that otherwise meets all requirements is less capable of employing basic interest rate swaps and interest rate caps than a $250 million credit union. The Department is opposed to this unnecessary asset threshold.

In summary, the Idaho Department of Finance is opposed to the NCUA's Proposed Rulemaking. The NCUA should not move forward with this proposal because it is an unwarranted preemption of the power of state supervisors to oversee the credit exposure of their state-chartered credit unions; it imposes unreasonable and excessive regulatory burdens; and it arbitrarily prohibits otherwise qualified credit unions from engaging in basic interest rate swaps and caps based on asset size.

Thank you for the opportunity to comment on the proposed rule.

Sincerely,

Gavin M. Gee
Director of Finance

cc: Honorable C.L. "Butch" Otter, Governor
Honorable Mike Crapo, U.S. Senator
Honorable James E. Risch, U.S. Senator
Honorable Mike Simpson, U.S. Representative
Honorable Raul Labrador, U.S. Representative
Chris Johnson, Idaho Credit Union League
Mary Martha Fortney, NASCUS