NCUA LETTER TO CREDIT UNIONS

NATIONAL CREDIT UNION ADMINISTRATION
1775 Duke Street, Alexandria, VA 22314

DATE: **February 2014** **LETTER NO.: 14-CU-04**

TO: **Federally Insured Credit Unions**

SUBJ: **Derivatives Applications Open March 3**

ENCL: **Supervisory Letter — Derivatives Examination Guidance**

Dear Board of Directors and Chief Executive Officer:

On March 3, the NCUA Board's final derivatives rule will take effect and allow federal credit unions to apply to use derivatives to reduce interest rate risk.

Federally insured, state-chartered credit unions (FISCUs) may engage in derivatives under a state parity provision, by following applicable state regulation, or through permission from the applicable state supervisory authority.[1]

NCUA's new regulation requires federal credit unions to apply for, and receive, NCUA approval before using the derivatives investment authority. It also limits a federal credit union's total derivatives exposure.

A FISCU must notify NCUA in writing at least 30 days before it begins engaging in derivatives transactions.

Which credit unions can apply to use derivatives?

The regulation applies specifically to **federal credit unions**, which much meet eligibility requirements (**assets of at least $250 million and a composite CAMEL rating of 1, 2, or 3**) in order to apply to use derivatives. An NCUA Field Director may permit selected federal credit unions with assets of less than $250 million to apply as well.

Which types of derivatives will NCUA authorize?

Approved federal credit unions will have limited authority to invest in simple interest rate derivatives for balance sheet management and risk reduction, including **interest rate swaps**, **interest rate caps**, **interest rate floors**, **basis swaps**, and **Treasury futures**.

[1] State parity provisions are reflected in state regulation or statute, and generally permit a FISCU to operate under the same authority as federally chartered credit unions.

Newly authorized derivatives features include amortizing notional amounts for swaps, caps, and floors. NCUA's regulation also authorizes forward start dates for swaps of 90 days or less.

The process for FISCUs to receive authority to use derivatives varies by state.

Why did the NCUA Board issue the derivatives rule?

It is critical that credit unions have management programs and tools in place to effectively anticipate and mitigate interest rate risk. With sound processes and controls in place, **derivatives can be an effective tool to help credit unions hedge interest rate risk** and better protect earnings and capital from adverse rate moves.

How will NCUA ensure the safety and soundness of derivatives programs?

NCUA is responsible for ensuring that all federally insured credit unions meet the standards for safe and sound operation of a derivatives program. The characteristics and risks of derivatives are unlike other financial products; so NCUA is issuing guidance to help credit unions adopt safe and sound practices associated with derivatives in order to protect the National Credit Union Share Insurance Fund.

NCUA has developed the enclosed Supervisory Letter to clarify the agency's supervisory expectations about derivatives products used by federal credit unions and federally insured, state-chartered credit unions.

I encourage you to review the enclosed guidance and to contact your regional office or state supervisory authority if you have any questions about derivatives.

Sincerely,

Debbie Matz
Chairman

Enclosure