CREDIT UNION

June 11, 2013

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

RE: Comments on Proposed Rule 12 CFR Parts 703, 715, and 741 to Allow Credit Unions to Engage in Limited Derivatives Activities to Mitigate Interest Rate Risk

Dear Ms. Rupp:

Thank you for allowing us to comment on Proposed Rule 12 CFR Parts 703, 715, and 741 that allows credit unions to engage in limited derivatives activities to mitigate interest rate risk. In general, we support the proposed rule as a prudent means of enabling credit unions to protect their net interest margins and capital positions in this historically low interest rate environment against the inevitable rise in market interest rates. We also support the imposition of prudent protections to limit derivatives use to legitimate risk mitigation purposes to protect the deposit insurance fund and industry against speculation.

It is important, however, that the rule be flexible, clear and cost effective enough to enable sufficient numbers of credit unions to use this risk mitigation tool. This was not the case under the pilot program, which resulted in little program participation. To this end we recommend the following amendments to the proposed rule:

(1) Section 703.105 (b). This section limits acceptable collateral to cash, treasury securities, fixed-rate non-callable agency debentures, and zero-coupon non-callable agency debentures. We recommend the language be clarified to specify that this section imposes requirements for a counterparty's collateral and the level of collateralization they must meet; and that the counterparty will dictate the collateral requirements the credit union must meet, which this section does not address.

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We also recommend that acceptable counterparty collateral be expanded to include agency mortgage-backed securities and pass-through certificates, which are fully guaranteed as to both principal and interest by either the Federal Home Loan Bank (FHLB), Federal National Mortgage Association (FNMA), the Government National Mortgage Corporation (Ginnie Mae) or the Federal Home Loan Mortgage Corporation (FHLMC). This would conform the proposed regulation to provisions in the standard ISDA Credit Support Annex, thereby, making it more feasible for credit unions and broker/dealers to enter into transactions.

(2) Section 703.105 (d). Subsection (d) states that a credit union must be collateralized daily for all transactions to at least 100 percent of the transactions, based on the risk of the collateral. This section is ambiguous and needs additional clarifying language. Discussions with NCUA staff indicate the intent was to require the credit union's counterparty to post collateral to at least 100 percent of the transaction. Furthermore "100% of the transaction" was intended to mean 100% of the exposure of the counterparty to the credit union based on the FMV of the derivative. If this was the intent, then the language needs to be clarified as it is currently ambiguous as written.

(3) Section 703.105 (c) and (j) (1). These sections require a credit union to price daily its derivatives position and calculate the fair market value exposure. It also requires a credit union's collateral management process to monitor its collateral daily and ensure the derivatives positions are collateralized at all times; and to post, track, value, and report positive and negative exposure using a daily fair value. We think the daily valuation and collateral monitoring requirement imposes an excessive burden on all but the largest credit unions and would preclude most credit unions from using this risk mitigation tool. We, therefore, suggest the valuation and collateral monitoring be done monthly as part of the monthly financial reporting process rather than daily, as this is more feasible.

(4) Section 103.108 (a) (3). This section requires qualified derivatives personnel at institutions applying for Level 1 authority to have at least three years of direct transaction experience in the trading, structuring, analyzing, monitoring or auditing of financial derivatives transactions at a financial institution. We think this imposes too burdensome an experience requirement, which most credit unions can't meet. The industry was previously prohibited from engaging in derivative transactions by NCUA (except for the limited number of pilot program participants), which precluded development of the specified expertise. We, therefore, recommend the regulation be amended to allow procurement of the necessary expertise through retention of a qualified external service provider.

(5) Application Fee. The proposed rule requires applicants to pay an application fee starting at $25,000 for Level 1 authority, and between $75,000 to $125,000 for Level 2 authority. We believe charging regulatory fees for specific authority is unprecedented and that the amounts would impose a large burden on smaller credit unions and preclude their use of this risk mitigation tool. We, therefore, recommend that the cost of regulating this new authority be funded through the current regular assessment rather than a special assessment since effective risk mitigation benefits the entire industry through reduced balance sheet risk and deposit insurance premiums.

Thank you for your consideration of our comments.

Cordially,

Kenneth W. Kramer

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