MEMBERS® Trust Company | Trust & Investment Services for Credit Union Members

July 19, 2013

Comments on Proposed Rules- Derivatives 12 CFR Parts 703, 715 and 741

From: Tom E. Walker, President &CEO
MEMBERS Trust Company, FSB
14025 Riveredge Drive, Suite 280
Tampa, Fl. 33637
888-727-9191

Mart Mcconnell, Managing Director
Provident Risk Management, LLC
13633 Providence Road, Suite 368
Weddington, NC 28104
704 756-1543

T0: Ms. Mary Rupp, Secretary of the Board

National Credit Union Administration

MEMBERS Trust Company, FSB, owned and managed by 40 credit unions, is regulated by the Office of Comptroller of the Currency, and provides investment management services to credit unions and their members including money management for excess liquidity held by credit unions.

Provident Risk Management LLC (PRM) provides derivatives consulting and derivatives support services primarily to Community Banks. The majority of PRM client banks have assets of less than $1 billion and many of our client banks have assets of less than $500million. PRM's professionals have significant industry experience and can provide key advice and counsel to implement conservative risk management strategies.*These strategies include the use of plain vanilla interest rate swaps and interest rate caps to manage balance sheet risks arising from interest rate volatility and mismatched maturities on the balance sheet for banks.

We are pleased to submit our comments on the proposed rule permitting Credit Unions limited derivatives activity to manage interest rate risk. With the combination of historically low market rates and recent increased rate volatility, credit unions will need these additional financial tools to manage interest rate risks arising with the maturity gap between their assets and liabilities.

Personnel Requirements

In our opinion, very few Credit Unions if any, could presently meet the new personnel requirements as defined by a 'Qualified Derivatives Personnel'. In addition, attempting to hire these experienced individuals would make this proposed rule cost prohibitive given the low transaction volumes we anticipate and the costs associated with a new hire.

Though we recognize there are significant differences between Credit Unions and Community Banks, in many cases they share a similar risk position with exposure to rising funding costs relative to a portfolio of fixed rate assets. They also face similar infrastructure challenges, with limited access to complex system and personnel with capital markets experience. It is our expectation that most Credit Unions, like Community Banks will use derivatives sparingly as an enhancement to existing Asset Liability Management procedures and that the level of derivatives trading activity will be low (in most cases less than five transactions per year, and in many cases only one transaction per year).

To address this issue, we propose a **Third Level of Authority** to be incorporated into the guidelines. *Under this level, the total number of transactions would be limited to ten (10) transactions per year and total outstanding notional amounts not to exceed 50% of the net worth . Also, the credit union seeking this authority would be required to retain a professional firm to provide advice, training, risk analysis and transactional review.*

Many Community Banks currently follow this practice to ensure sound management and board oversight by engaging professionals to provide training and by following policies and procedures. These banks require a clear statement of hedging objectives and risk management policy for each hedging strategy. The banks stress test proposed hedging strategies to understand changing risk profiles in up and down markets and in many cases by modeling a theoretical maximum potential exposure.

In addition we recommend that Credit Unions that are FHLB members have the option to use the FHLB as their Derivatives Counterparty. In our experience a large number of Community Banks have elected to use their FHLB as the Derivatives Counterparty. The benefits of executing a derivative with the FHLB are the FHLBs AAA rating, the FHLB's unique collateral requirements for derivatives and the elimination of the administrative burden associated with managing collateral. In many cases FHLB is also better equipped to credit approve swaps with smaller financial institutions.

In general a swap between a community bank and the FHLB is secured under the pledge and security agreement between the FHLB and the member institution. Members do not face any additional requirement to post liquid collateral, though in most cases the FHLB will reduce the availability of a member's credit line in response to credit exposure related to changes in the fair value of a swap.

FHLBs are not registered Swap Dealers. FHLBs generally do not enter two way collateral arrangements with community banks (though the FHLB's obligation to pay on a swap is a general obligation of the agency on par with Agency securities).

Legal Opinions

Market standard practice does not require Community Banks to deliver a legal opinion attesting to the authority of a bank to execute an ISDA Master Agreement or a related hedge transaction. Most Community Banks and Credit Unions do not have in house legal counsel with derivatives experience. Under the proposed rules Credit Unions must receive authority from the NCUA to enter into hedge transactions. Hedge transactions will be subject to documented policies and procedures and must be approved by Management and the Board.

Clarification of Hedging Indexes

To date most of our clients have elected to structure swaps using USD LIBOR as the underlying hedge index. USD LIBOR is specified as a Benchmark rate for the purposes of ASC 815 (hedge accounting for derivatives), in addition the FASB is considering a proposal to add the LIBOR OIS index as a benchmark rate. *We request clarification that USD LIBOR indices, LIBOR OIS, USD Prime, Fed Funds and US Treasuries will all be permissible hedge indices.*

In Summary, we would like to commend the Board for recognizing the need for a rigorous risk management structure which emphasizes the need for an informed and educated Board of Directors and Management team, sound policies and procedures, clear risk limits and risk policies for Market Risk, Credit Risk, Liquidity and Legal Risk.