WSECU

WASHINGTON STATE EMPLOYEES CREDIT UNION

July 25, 2013

National Credit Union Association
Attn. Mary Rupp, Secretary of the Board
1775 Duke Street
Alexandria, VA 22314-3428
regcomments@ncua.gov

Re: Proposed rule, use of derivatives

Thank you for providing credit unions and other concerned stakeholders the opportunity to comment on NCUA's proposed rules on the use of derivatives.

My previous credit union, (Verity Credit Union, Seattle WA) participated in NCUA's derivatives pilot program. While there, I saw first-hand how derivatives benefitted our credit union during times of rising rates and helped to absorb the impact of that rate-environment. I also saw how interest rate swaps could be costly during times of falling rates and knew that, when employing a derivatives strategy, a credit union must understand the impact derivatives may have during rising and falling rates.

I have long felt the use of simple derivative products can serve as effective hedges against interest rate movements and applaud NCUA's proposed rule to permit credit unions to engage in limited derivatives activities for the purpose of mitigating interest rate risk (IRR). Furthermore, I agree with many if not most of the provisions of the proposed rule and feel that it provides a good entry point for more credit unions to strengthen their toolkit of IRR management.

The proposed rule seeks comments on a number of key issues related to credit unions' use of derivatives as an IRR mitigation tool. What follows is WSECU's input:

1. "The Board seeks comment on whether credit unions believe that complex swap structures are necessary and, if so, why".[1]

   WSECU agrees that initially, "plain vanilla" derivative structures are appropriate for most credit unions who apply for Level I or Level II derivatives authority. That said, we believe that with changing market conditions, some credit unions may have hedging needs that "plain vanilla" hedging tools do not sufficiently mitigate. We believe that NCUA should develop a process where a credit union can petition, on an individualized basis, for additional authority when warranted. This process need not be dissimilar to the process for petitioning for additional authority as it relates to other investments such as securities.

2. "In addition to application fees, the Board is seeking comments on the pros and cons of recovering the costs of ongoing supervision of credit unions engaged in derivatives".[2]

[1] Federal Register/Vol. 78, No. 103/Wednesday, May 29, 2013. Page 32196
[2] Federal Register/Vol. 78, No. 103/Wednesday, May 29, 2013. Page 32204

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WSECU feels strongly that the introduction of application and ongoing fees would set a bad regulatory precedent and could bring unintended consequences that could affect overall credit union industry safety and soundness. It may incent regulators to develop and charge for other regulatory authorities or create a situation where the regulator is captured by larger players who are involved in fee driven activities.

a. The introduction of application and licensing fees may act as a deterrent to qualified credit unions who should, but because of cost considerations, do not use derivatives to mitigate IRR. History has shown instances of improper interest rate risk management causing the failure of numerous financial institutions. We believe that credit unions that participate in a derivatives program will sustain fewer losses than those who do not, which will benefit the NCUSIF and indirectly, all federally insured credit unions. For those reasons, it seems counterintuitive to introduce a fee structure that could deter participation in a program that could bring such benefits.
b. Granted, a derivatives program can be complex to implement and oversee. That said, the use of derivatives is to increase safety and soundness for credit unions and not to speculate or increase profits. Many credit unions have engaged in and have subsequently failed, at great cost to the NCUSIF and indirectly, all federally insured credit unions, due to the implementation of complex financial instruments such as exotic first mortgages, commercial loans and loan participations and private-label mortgage-backed securities. These other financial instruments are also very complex and take additional NCUA resources to oversee and examine, but do not come with an application or licensing fee. Another striking difference between derivatives and the other complex financial instruments named above is that the other complex financial instruments were generally used to generate profits for a credit union and not as a risk mitigation tool. Charging fees to engage in risk mitigation and not for profit motivation seems counterintuitive and sends an unclear message to credit unions as to what complex activities NCUA recommends credit unions be engaged in.
c. As budgets are tightened and funding for ongoing regulatory and examination functions are stretched, the introduction of fees for credit unions to engage in and remain in various business activities could blur the Regulator's focus from safety and soundness to fee generation.
d. If fees are introduced for various business activities, that are primarily geared toward larger credit unions and those fees become a meaningful portion of the Regulator's annual revenue, there become the risk that the NCUA become a "Captured Regulator". The outside influence of a specialized fee structure, geared toward larger credit unions who will invariably be engaged in complex activities should be avoided in order to shield the NCUA from the undue influence that the regulated who pay those specialized fees could bring.

Thank you again for giving credit unions and other interested stakeholders the opportunity to comment on NCUA's proposed rules regarding the use of derivatives as an IRR mitigation tool. Aside from the comments noted above, WSECU is generally supportive of the framework and structure that NCUA has designed for credit union derivatives authority.

If you have questions regarding any of our comments, please feel free to contact me directly at rgunderson@wsecu.org or 360-754-6147.

Sincerely,

Randy Gunderson
Chief Financial Officer

Cc. Linda Jekel, Director of Credit Unions, Washington Department of Financial Institutions