CREDIT UNION ASSOCIATION OF THE DAKOTAS

July 25, 2013

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

RE: Comments on Proposed Rule – Derivatives

Dear Ms. Rupp,

The Credit Union Association of the Dakotas (CUAD) appreciates the opportunity to provide comment to the National Credit Union Administration (NCUA) with regard to the derivatives proposed rule. To provide a brief background, the Credit Union Association of the Dakotas represents seventy state and federally chartered credit unions in the states of North Dakota and South Dakota, whose assets total $5.1 billion and who have more than 450,000 members.

The Credit Union of the Association supports credit unions' authority to engage in derivative transactions as a way to mitigate interest rate risk. Overall, CUAD supports the NCUA's objective in allowing credit unions to engage in limited derivatives transaction with the goal of mitigating interest rate risk and reducing risk to the National Credit Union Share Insurance Fund (NCUSIF). However, CUAD does disagree with a few aspects of the proposed rule and believes that changes can be made to better assist credit unions in mitigating interest rate risk while still achieving NCUA's objectives and addressing NCUA's concerns that were expressed in the discussion of the proposed rule.

With regard to proposed §703.100(a)(2), the proposal currently reads that the requirements of the subpart apply to "Federally insured, state-chartered credit unions that are permitted to engage in derivatives transactions under applicable state law." Repeatedly in the discussion of the proposed rule, the NCUA uses the word "expressly." Specifically, "…all federally insured state- chartered credit unions (FISCUs) that are expressly permitted by applicable state law to engage in derivatives transactions," [emphasis added] *78 FR 32191* and "this proposed rule does not grant any FISCU authority to engage in derivatives if applicable state law does not expressly allow it." [Emphasis added] *78 FR 32194.* CUAD recommends that this provision be changed so that a Federally insured, state-chartered credit union may engage in limited derivatives transactions unless *prohibited* under state law. This will allow FISCUs that are not otherwise currently prohibited under state law to engage in the limited derivative activity once the final rule is adopted. Otherwise, it could potentially be several years until a FISCU could utilize limited derivative activity to mitigate interest rate risk and thereby reduce risk to the NCUSIF as the FISCU waits for legislative action. This would be true especially in states, such as North Dakota, where the legislature is not in session every year.

CUAD is strongly opposed to the implementation of application fees and supervision and/or examination fees. With regard to application fees, the discussion in the proposed rule suggests that Level I fees are proposed to start at $25,000, while Level II fees may range anywhere from $75,000 to $125,000. One of the reasons the NCUA gives for considering an application fee is to act as a deterrent to "credit unions that are unsure whether or not they can meet all of the qualifications required to implement a safe and sound derivatives program." Most credit unions do not have the time to causally complete a long application, which as proposed would require a significant amount of information and upfront staffing requirements, when they are still "unsure" if they can meet the required qualifications. The NCUA should not charge any additional fees associated with any potential limited derivative program a credit union may engage in, including but not limited to, annual licensing fees, examination time and/or any additional yearly charge.

The NCUA explains that, "…given the historically low interest rate environment of the last few years, IRR now poses a material risk to many credit unions. Recognizing that derivatives can be beneficial in helping credit unions to mitigate IRR, the Board believes it is appropriate to allow credit unions to use derivatives for the limited purpose of IRR mitigation." *78 FR 32192.* Engaging in limited derivative activity would also reduce risk to the NCUSIF as noted above. If this is a tool that credit unions can use to mitigate risk and will also reduce risk to the NCUSIF, why should credit unions be forced to pay to utilize this tool which is meant to protect the individual credit union and would also benefit credit union industry? CUAD believes that any application fees and/or supervision/examination fees would act as a deterrent to qualified credit unions from using derivatives to mitigate IRR.

Furthermore, from a budgetary standpoint, the NCUA has not provided support for a need to charge fees above what it already collects from credit unions. The number of FCUs and FISCUs has steadily deceased each year over the last few years. In 2003 there were 5,776 FCUs. As of December 31, 2012, there were only 4,272 FCUs. With regard to FISCUs, in 2003 there were 3,593. As of December 31, 2012, there were only 2,547. However, despite the decrease in the number of credit unions, the NCUA's budget has continued to increase. In 2010, the total operating budget was $200.0 million. In 2011, the total operation budget increased to $225.4 million. In 2013, the total operating budget is $251.4 million which is a $14.5 million increase from 2012 when it was $236.9 million.

The NCUA's proposed rule limits permissible derivatives transactions to interest rate caps and interest rate swaps. CUAD believes that the NCUA should include a waiver process for credit unions that may have the need, experience either in house or through a third party, support and resources to engage in more complex swap structures.

The NCUA has proposed, as an eligibility requirement, an asset threshold of $250 million. The NCUA states that, "Credit unions with more than $250 million in total assets have nearly twice the exposure to fixed rate assets and hold a much greater share of non-core deposits than credit unions with $250 million or less in assets." *78 FR 32197.* While credit unions with over $250 million in assets have "nearly twice the exposure" credit unions with under $250 million also have exposure and would benefit from utilizing derivatives to mitigate interest rate risk. CUAD proposes that either this asset threshold be removed or alternatively a waiver process be implemented to allow for credit unions under $250 million that otherwise meet the qualifications for engaging in derivative transactions to be allowed to do so.

Finally, CUAD is opposed to the level of experience that in-house staff is required to possess prior to a credit union being able to engage in derivative transactions. CUAD believes that adequate safeguards can be incorporated into contracts to allow external service providers to provide the required support other than what would be allowed for under the proposed rule. "The proposed rule requires three years of experience for qualified derivatives personnel at a credit union seeking Level I authority and five years of experience for Level II." *78 FR 32199.* This experience must be "direct transactional experience in the trading, structuring, analyzing, monitoring, or auditing of financial derivatives transactions at a financial institution, a risk management advisory practice, or a financial regulatory organization." *78 FR 32209.*

The NCUA explains in the proposed rules discussion that the, "The Board recognizes the comments on ANPR II stating that NCUA should not condition approval on experience requirements. The Board believes that without qualified staff, however, a credit union will not be able to safely and effectively manage a derivatives program." *Id.* CUAD requests that the NCUA reconsider its position on this matter to allow credit unions to engage the wealth of knowledge and experience that can be found in external service providers. Under the current proposed rule, a credit union would need to hire an individual with the requisite amount of experience, assuming that credit unions do not currently employ many if any such individuals since credit unions could not previously engage in derivative transactions. Then the credit union would need to apply to the NCUA to be able to engage in such activities and if the credit union's application is not approved what are they to do with this newly hired person? Attracting a knowledgeable and experienced candidate for a position that may or may not exist because it is based on the future approval of an application would be challenging if not impossible. The NCUA is setting overly burdensome, if not impossible, standards for a credit union to meet to be able to utilize a tool that is meant to mitigate risk.

Proposed §703.108(a)(3) goes on to require that this employee, must be able to accomplish at least, "(i) *Asset/liability risk management.* Staff must be qualified to understand and oversee asset/liability risk management including the appropriate role of derivatives. This includes identifying and assessing risk in transactions, developing asset/liability risk management strategies, testing the effectiveness of asset/liability risk management, determining the effectiveness of managing interest rate risk under a range of stressed rate and statement of financial condition scenarios, and evaluating the relative effectiveness of alternative strategies; (ii) *Accounting and financial reporting.* Staff must be qualified to understand and oversee appropriate accounting and financial reporting for derivatives transactions in accordance with GAAP; (iii) *Trade execution and*

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oversight. Staff must be qualified to undertake or oversee trade executions; and (iv) *Credit, collateral, and liquidity management.* Staff must be qualified to evaluate credit risk, manage collateral, and evaluate liquidity risk, as described in §§ 703.105 and 703.106 of subpart B of this part." *78 FR 32209.* These functions can easily and safely be performed by an external service provider and therefore the requirements under proposed §703.108(a) and (e) should be revised to allow credit unions to utilize outside experience and knowledge and not create overly burdensome hurdles that the credit union must meet.

Thank you for this opportunity to share our comments.

Respectfully,

Robbie Thompson

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CEO/President

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Director of Compliance