FIRST COMMUNITY CREDIT UNION®

July 26, 2013

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

Dear Ms. Rupp:

On behalf of the First Community Credit Union and its management staff, I am writing in response to the Notice of Proposed Rulemaking - Derivatives. We thank you for this opportunity.

We support the authority of credit unions to engage in derivative transactions as a means to hedge against interest rate risk. Without the ability to hedge using derivatives, institutions are forced to either take undue amounts of interest rate risk or manage their balance sheets in sub-optimal ways. Derivative use can clearly reduce the industry's sensitivity to increases in interest rates and ads to the stability of the NCUSIF. Our credit union in particular would like the opportunity to hedge against interest rate risk.

Since the benefits sought in using derivatives is to reduce interest rate risk, the proper usage of derivatives should therefore be encouraged, not discouraged. The rules as proposed are too narrowly written, overly costly, and set bad precedence.

Application Fee:

Derivatives can enhance profits by preventing poor income results. We therefore believe that charging to better manage risk is the wrong approach. The upfront costs of the fees add to the barriers of starting and maintain a derivatives program and will discourage smaller credit union from creating one, thus increasing the risk to those credit unions and the reliance on other less optimal methods.

More importantly, application fees would set an unwelcome precedence. No other program requires a separate fee to start and operate. Supervision fees have never been and should not be operated in an a la cart manner. While on the surface it would seem logical to charge more complicated credit unions to review this program, it ignores the fact that they are already paying the lion share of regulatory costs. The costs should be funded through the regular assessment process.

Asset Size Limitations:

The proposal to limit authority to credit unions that are $250 million or larger appears to be arbitrary and not necessary. A $150 credit union with heavy concentration of mortgage loans is in more need of an interest rate risk mitigation program than a larger credit union specializing in consumer auto loans. The complexity and cost of the program should be enough to limit credit unions to those who need it.

Qualified Derivatives Personnel:

The requirement to hire internal staff with over three years direct transactional experience would be costly and would be a daunting barrier for smaller credit unions. Up until this point, derivative hedging has mostly been prohibited, thus limiting the ready pool of qualified credit union personnel to draw from. Credit unions should be allowed to achieve the experience and qualifications through the use of third party consultants.

Collateral Requirements:

The Section 703.105 requirements for acceptable collateral are limited to cash, Treasury securities, fixed-rate non-callable agency debentures, and zero-coupon agency debenture. This is too restrictive. Pass-through securities and mortgage-backed securities should be allowed as collateral also. Pass-through securities are very liquid and are easy to price.

Audit Requirement:

The requirement to engage outside auditors to perform an annual internal controls audit is costly, excessive and unnecessary. Programs that are just as complex and risky, such as commercial lending or CMO investments, do not have this requirement. At a minimum internal audit personal should be allowed to conduct the review.

Settlement Requirements:

The restriction to limit settlement within three business days will prohibit forward starting trades that can be used in lieu of options on swaps and will have a negative impact on an effective hedging strategy. Forward starting interest rate swaps will allow credit unions to pay a premium to mid-market pricing for a swap that will commence at a predetermined forward start date. The swap will commence when the credit union deems it necessary.

Section 703.109 – Specific Level I limits and requirements:

(a) A credit union approved only to enter into interest rate swaps must restrict the aggregate notional amount of its interest rate swap transactions to 100 percent of net worth. - This is too restrictive. As interest rate swaps age, they decrease in duration and lose some of their hedging benefit, potentially requiring additional hedges, making a notional exposure amount illogical. Notional limits should not be required. If limits are to be required, we suggest that the risk weighted notional limit of interest rate swaps for Level I be set as a percentage of the credit union's assets. The lower the net worth ratio, the greater the need there is to have use of derivatives to mitigate interest rate risk. By using net worth as the limiting ratio, credit unions with the greater need are restricted to a smaller limit.

(b) A credit union approved only to purchase interest rate caps must restrict the aggregate book value of its interest rate cap transactions to 10 percent of net worth.

(c) A credit union approved to transact interest rate swaps and purchase interest rate caps may not exceed a combined limit of 100 percent of the aggregate amount of each limit the credit union used under paragraphs (a) and (b) of this section. For example, a credit union may hold

80 percent of the limit for interest rate caps and 20 percent of the limit for interest rate swaps, but cannot hold 100 percent of the limit for each.

The limits set forth for interest rate caps are acceptable, but should not be combined with notional limits of interest rate swaps. As stated, these limits should be set as a percent of assets.

(d) The aggregate fair value loss of all swap positions into which the credit union has entered cannot exceed 10 percent of net worth.

Limits on mark-to-market changes independent of the asset or liability being hedged are inappropriate and will negatively impact effective hedging strategies. Theoretically, if there is a loss on the derivative there should be a gain on the asset. Therefore, the market valuation limit should take into consideration the asset or liability being hedged.

The 10 percent net worth limit should be based as an exposure to the aggregate mark-to-market limit, including gains on the hedged item.

(e) The maximum permissible weighted average life on all derivatives positions may not exceed five years and the maximum permissible maturity for any single derivatives position may not exceed seven years.

Maturity and average life restrictions are arbitrary and inappropriate for effective hedging strategies, especially because in-the-money trades are collateralized. At the very least, maturities should be allowed at 20 years with no weighted average life restrictions.

Section 703.110 – Specific Level II and requirements;

As stated for Section 703.109, notional limits are illogical, and at the very least should be stated as a percentage of assets. Maturities should be allowed to be at least 20 years with no weighted average life restrictions.

We thank you for allowing us the opportunity to comment. We are hopeful NCUA finds these suggestions useful. If you have any questions, please feel free to contact me at (281) 856-5456

Sincerely,

Keith R Domingue, CPA
EVP/Chief Financial Officer
First Community Credit Union