July 26, 2013

Via e-mail

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

Dear Ms. Rupp:

On behalf of Westerra Credit Union, we are writing in response to the Notice of Proposed Rulemaking - Derivatives. We believe that certain derivatives can offer a diligent approach to managing credit unions' interest rate risk and can effectively reduce risk throughout the industry. We thank NCUA for considering expanded derivatives authorities for the industry and for the opportunity to provide feedback. Our feedback centers on the cost of the proposed regulation.

Qualified Derivatives Personnel

According to the proposed regulation, to engage in derivatives transactions with Level I authority a credit union must generally have knowledgeable and experienced employees that have at least three years of 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.

This level of specialized employee experience will be very costly for credit unions to obtain, and as most credit unions will perform just a few derivative transactions each year, having someone with that experience level on staff would not be cost effective. In addition, reliance on a single employee for derivatives oversight and detailed knowledge also creates a potential exposure when that employee leaves the organization. We agree that credit union management needs to gain and maintain a strong understanding of derivatives prior to performing derivative transactions; however we feel this can be most cost-effectively accomplished through adequate training, monitoring and reporting requirements and partnering with outside experts. We respectfully request that this proposed provision be revised to allow for a broader set of finance backgrounds and transactional experience for those involved in overseeing a credit union derivatives program, together with requirements around on-going training, monitoring and reporting.

Internal Controls Review

The proposed regulations state that a credit union must have an internal controls audit at least annually that ensures the timely identification of weaknesses in internal controls, modeling methodologies, and the risk oversight process. This internal controls review must be performed by external individuals qualified to *evaluate the attributes of a derivatives program. An internal controls audit must incorporate an evaluation of the effectiveness of internal controls relevant to measuring, monitoring, reporting, and limiting risks. The scope of the internal controls review must also include coverage of the accounting, legal, operating, and risk controls.*

A credit union's Supervisory/Audit Committee has a responsibility to ensure that internal controls are established and effectively maintained to meet financial reporting objectives and safeguard member assets. As a best practice, this would include conducting a periodic enterprise wide risk assessment to identify areas of greatest risk that would most benefit from internal control audits. As internal audits are very costly, mandating that a specific area of credit union operations be audited on an annual basis would likely cause audit dollars to be redirected away from other, potentially much riskier operational areas. Credit unions should be encouraged to conduct regular reviews of derivative program internal controls, modeling methodologies, and oversight as part of an overall internal audit plan that assists the Supervisory/Audit Committee in fulfilling their responsibilities versus mandating a specific audit schedule and scope for this one area of operations.

Application Fees

Finally, we are opposed to the idea of instituting a fee structure for those credit unions that apply for derivative authority. Derivatives are a common practice for financial institutions outside the credit union industry, and its introduction is not dissimilar to other introductions of new products to credit unions', such as CMOs or commercial loans. In those cases, credit unions were not assessed a fee to participate in products already widely available to other financial institutions. Granting derivatives authorities to credit unions is a prudent step to reduce interest rate risk throughout the industry. It is inappropriate for NCUA to assess a transaction fee for activities that actually reduce risk to the share insurance fund.

Under the current proposed regulations, implementing a derivatives program would be cost-prohibitive for most of the credit union industry. Without this effective interest rate risk mitigation tools, credit unions may take on excessive risks within their balance sheet or sacrifice net worth growth by performing costly borrowing hedges. Derivatives can be a cost-efficient option to lower risk and maintain credit union competitiveness with other financial institutions. However, the NCUA's current proposal would negate any potential cost benefits and would ultimately deprive most institutions of a valuable risk mitigation tool.

Sincerely,

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