Connex
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July 26, 2013

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

RE: Notice of Proposed Rulemaking, Part 703 - Financial Derivatives Transactions to Offset Interest Rate Risk

Dear Ms. Rupp,

I am writing in response to your call for comments from the community regarding NPR Part 703-Financial Derivatives Transactions to Offset Interest Rate Risk. I am the President and CEO of Connex Credit Union based in North Haven, Connecticut. We are an institution that would benefit from the ability to utilize derivatives to manage the interest-rate risk (IRR) of our balance sheet, allowing us to better meet the needs of our members while protecting their capital. We are a state-chartered credit union, and as such, authority already exists within CT State statutes. My initial concern is that the structure being considered by the NCUA is too onerous relative to our expectations in requesting approval through our State regulators.

We have approximately $400 million in assets and are growing, with a strong balance sheet, capital ratio, and CAMELS ratings; we therefore meet the proposed eligibility requirements. We have managed IRR previously through diligent ALM protocol and balance sheet management. We chose not to portfolio long term mortgage loans years ago when interest rates fell below 5%; that resulted in approximately $200M in mortgage loan balances that are off-balance sheet. Certainly, there was income opportunity that was foregone with the expectation of rising interest rates. However, we perceive that our members will increasingly want the ability to access longer-term real estate loans, and we would prefer to manage that portfolio, rather than mitigate that risk through passing the loans to a third-party processor. Passing the mortgages off our balance sheet does not have us meeting the best interest of our members or maximizing the benefits of our relationship.

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There are a number of issues in the NPR that could prove to be substantial hurdles for an institution of our size to participate in such an important program. My concerns are outlined in more detail below:

1. Requirement of the credit union to demonstrate need before it is granted authority

My initial reaction to this particular section is how the definition of "need" will be clarified, and what subjective interpretations might influence decisions around the threshold for "need." We currently do not have a "material" need to utilize financial derivatives in our IRR management because, as mentioned previously, we are managing that risk through financial instruments on the balance sheet. However, we would like to have the ability to be proactive, and enter into such agreements before assuming the risk associated with keeping our longer-term member mortgages; this will enable us to meet our members' needs in a timely and flexible manner. The proposed infrastructure to support this program (additional staff, board training, back-office system support, daily pricing, attorneys' with 5 years of derivative experience) would require time and financial resources; in addition, the requirement to have these support structures in place in advance of application submission and approval seems to be too restrictive and costly.

It would be preferable for the NCUA to consider this program a proactive regime, and not a reactive solution. The NCUA's 90-day minimum turnaround on the approval decision seems to be too long a time, and is at odds with an attempt to be proactive, versus a "need" to react to balance sheets risks already assumed. It should emphasize that this option should not be considered a remedy, as the original risk need may have exacerbated considerably before approval is granted.

2. Minimum derivatives experience requirement to receive independent derivatives authority

Given our CAMEL ratings, we have repeatedly demonstrated that we would be utilizing these instruments in a prudent and judicious manner. The requirement that we have staff members with over three years of derivative trading and valuation experience to support such a small portfolio is a hurdle that would prevent or limit participation from all but the largest credit unions. It appears that we are exactly the type of institution that should be encouraged to look towards these types of tools to mitigate risk; therefore we should be allowed to utilize qualified third-party vendors to support our staff while we build our in-house expertise. In addition, retaining third-party expertise will allow us to access specific derivative experience in proportion with our needs, with us hiring external talent if our program expands enough to justify expensive staff resource support. I submit that the NCUA should weigh the importance of internal experience against the notional amount of the hedge undertaken.

3. Annual licensing fee to engage in derivative activity

As mentioned previously, our participation in this market will likely be minimal, expanding with our experience and need. While our initial investment in certain program infrastructure is necessary and prudent to protect the well-earned capital of our members, the NCUA should also recognize the value of these instruments and their use for credit unions of all sizes, including the smaller institutions. Charging institutions, already facing large investments to support these programs, for additional industry oversight through annual licensing fees not only discourages smaller credit unions from using these tools, but limits the growth and profitability of the industry. I strongly encourage the NCUA to reconsider applying a fee for participation in a program that will only improve the risk profile of the credit union industry overall.

Furthermore, the NCUA is considering a change to a long-standing practice by now recommending a specific supervision fee for a specific activity. Will this change be considered for other activity that exists in credit unions today? Commercial lending and Indirect lending activities are two areas that might warrant a similar level of increased risk and supervision; should some consideration be given to these and other areas? As structured, this NPR is being allowed to reduce IRR exposure, not gamble on interest rate movements, so there is an industry – wide benefit that should be correlated to reduced exposure to future assessments. The same can hardly be said for commercial lending and indirect lending. I'd be concerned about where the NCUA intends to "draw a line in the sand."

Connex is very interested in participating in an approved program which would allow us to mitigate interest rate risk without adversely affecting net income or the capital ratio of our institution. The ability to utilize these financial tools would not only limit risk to our balance sheet, but would allow us to fully realize the relationship with our members, enhancing our ability to grow their investment and trust in our organization.

Thank you for your time and attention to these comments. I would be happy to discuss them in further detail at your convenience.

Regards,

Frank Mancini

Frank Mancini
President/CEO

FM/dmr