VIA E-MAIL TRANSMISSION
regcomments@ncua.gov

July 29, 2013

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

Re: Notice of Proposed Rulemaking for Parts 703, 715 and 741. Derivatives.

RIN 3133-AD90

Dear Ms. Rupp:

The Illinois Credit Union League represents over 340 credit unions in Illinois. We are pleased to comment on the NCUA's Notice of Proposed Rulemaking on derivatives activities (the "Proposal"). The Proposal is an encouraging step by the NCUA towards providing practical solutions in an extraordinary period of over-regulation. The NCUA has identified Asset Liability Management ("ALM") as a priority for credit unions, and expanding investment authority to derivatives transactions gives credit unions a feasible tool in preparing for eventual market shifts, thereby addressing ALM.

The Proposal's intent is to afford credit unions the ability to invest in certain "plain vanilla" derivatives in order to mitigate interest rate risk ("IRR"). Like all actions taken by credit unions, these transactions are required to be conducted in a safe and sound manner so as not to adversely affect the financial position of the institutions themselves or the National Credit Union Share Insurance Fund (the "NCUSIF"). The Illinois Credit Union League supports this concept, but feels it can be achieved through far less burdensome means. As discussed in this letter, the impact of the requirements and restrictions that must be met to engage in derivatives investments wholly eliminates a majority of credit unions from even participating and imposes unneeded costs and excessive compliance strains on those who do. IRR is an issue faced by all credit unions, not just those with the capital to endure the regulatory gauntlet in place to invest in derivatives under the Proposal. Similarly, all credit unions will need investment tools such as derivatives to protect their net interest margins when interest rates inevitably rise. It is counterintuitive for the NCUA to put forth unnecessary barriers that discourage and prohibit participation of the credit unions that could benefit most from this tool. The Illinois Credit Union League, on behalf of its nearly 350 member credit unions, highlights the following concerns and urges the NCUA to amend the Proposal and create a cost-effective procedure for credit unions to invest in simple derivatives transactions.

Application Fees

The Illinois Credit Union League opposes the NCUA's consideration of imposing an application fee and ongoing supervisory fees as part of the Proposal. The charging of additional regulatory fees for a specific authority is unprecedented and only further discourages credit unions from using a risk mitigation instrument that is a benefit industry wide. The proposed application fee range (depending on the authority applied for) ranges from $25,000 to $125,000, which is not only a disincentive for credit unions, it could be cost prohibitive in many instances. The NCUA must remember the ultimate goal of the proposal – to mitigate IRR and to safeguard the NCUSIF from the adverse impact created when interest rates increase. A credit union taking steps to mitigate risk is an activity the NCUA should be incentivizing, especially if such an action is done through the prevention of poor income results when derivatives are used to hedge rate fluctuations.

The fee concept in the Proposal is also an alarming move by the NCUA to institute an a la carte regulatory fee system. Such a progression would only suppress the motivation of credit unions to engage in any additional investment or lending pursuits, regardless of their benefit to the credit union or the industry as a whole. The NCUA must develop the expertise and staffing required to administer the Proposal using existing fees and cannot revert to the big government stereotype of simply increasing its revenue to meet additional responsibilities. In the current environment, credit unions are constantly required to comply with a never-ending stream of regulatory mandates, but by operating in the private sector, they cannot merely saddle their members with all the additional costs and in turn must increase efficiencies. If the NCUA requires credit unions to do more with less, they must do the same.

Asset Thresholds

A $250 million asset threshold to obtain derivatives authority is not needed to achieve the Proposal's objectives. In fact, akin to the charging of separate fees, setting a superfluous asset threshold only eliminates credit unions that would otherwise benefit from investing in derivatives. The Proposal identifies this threshold as inclusive of those credit unions with the "capacity" to take advantage of derivatives investments. If the NCUA desires to utilize asset size as the indication of a credit union's sophistication and wherewithal to conduct derivatives transactions, then there is no need for the Proposal to set forth the myriad of additional requirements a participating credit union must meet. The Proposal currently contains CAMEL rating requirements, restrictions on eligible counterparties, collateral requirements, advanced personnel expertise, audit and reporting standards, a separate legal opinion, and investment limits. If the NCUA feels the appropriate business acumen to utilize derivatives correlates to asset size, then these additional requirements are redundant, excessive and only serve to increase the cost of regulation for the NCUA. Conversely, if the NCUA determines the substantive requirements are necessary, then why would it prohibit a credit union under $250 million that can meet all those standards from engaging in an activity that will mitigate risk to the benefit of both the credit union and the NCUSIF?

Personnel and Third Party Requirements

The staffing, personnel and third party requirements contemplated by the Proposal go beyond the necessary components to efficiently and responsibly engage in simple derivatives investments. Section 703.108 of the Proposal begins by mandating a form of derivatives training for credit union board members. Such a concept was thoroughly discussed, and opposed, by the Illinois Credit Union League, CUNA, other state leagues and federally chartered credit unions when the NCUA promulgated rules related to fiduciary duties of directors in 2010. Members of a credit union board are already bound by an expansive body of common law that dictates their appropriate behavior and knowledge. The member/owners of a credit union must have the independent authority to select volunteer board members based on a wide variety of backgrounds and skills. The Proposal's interjection of board training mandates only hinders credit unions' ability to attract competent and energetic volunteer directors, and adds another burdensome, aimless compliance obligation.

Setting specific derivatives experience thresholds for personnel is not the most cost effective means to ensure credit unions maintain staff with the knowledge to implement a derivatives program. The scope of the Proposal limits derivatives investments to swaps and caps in an effort to mitigate IRR, and the credit union industry contains many experienced employees with decades of experience working in sophisticated financial institutions that have the ability to successfully manage these transactions. Except for the small pilot program participants, credit unions have been banned from derivatives investing, thereby precluding the needed employee development and making the retention of personnel with the Proposal's specified direct derivatives experience (3 years for level I and 5 years for level II) extremely costly. A better approach would be to allow credit unions to utilize existing staff and supplement their skills with outside service providers. The NCUA should work with outside entities in order to provide credit unions with the supplemented services needed to manage derivatives programs.

The internal controls audit and formal legal review components of the Proposal, sections 703.108(b)(3) and 703.108(b)(5), respectively, will cause credit unions to incur unneeded additional expense and compliance barriers. Credit unions will already be facing an increased cost in finding auditors familiar with derivatives to conduct external audits. Requiring an internal controls audit is redundant when an external auditor with derivatives experience can provide the credit union and the NCUA a sufficient appraisal of the proper controls needed for an adequate derivatives program. Additionally, setting experience requirements for a required legal review is duplicative of ethics standards all attorneys are required to follow. Anytime a credit union seeks legal counsel, the attorney must have the appropriate amount of experience and knowledge of the legal issue presented prior to engaging in legal services. Setting an arbitrary five years of experience requirement only serves reduce the pool of qualified attorneys the credit union has to use, further increasing costs and compliance burden. All attorneys are prohibited by relevant state ethics rules from offering an opinion on legal matters they are not knowledgeable of, which makes the Proposal's requirement a moot point. The Illinois Credit Union League urges the NCUA to remove the "Qualified counsel" definition from the proposal and mandate legal review only when additional terms are being added to a previously reviewed boiler-plate agreement.

Reporting

Requiring a full net economic value to the board on a monthly basis (section 703.107 of the Proposal) is a significant deterrent for credit unions contemplating the use of derivatives investments. Senior level management with the requisite expertise described above should maintain the authority conduct derivatives transactions in accordance with the credit union board's adopted policies with only quarterly reporting cycles. The NCUA should also consider allowing credit unions to outsource the reporting standards, especially for smaller institutions that are conducting a small volume of transactions. Relying on third parties that already have the necessary components in place to produce proper reporting assists credit unions in reducing costs without sacrificing the proper due-diligence needed to meet safety and soundness standards. The Illinois Credit Union League suggests the NCUA amend the proposal to allow for quarterly reporting, giving credit unions the option of utilizing outside vendors.

Valuations, Investment Limits and Collateral

The Illinois Credit Union League agrees with the Proposal's inclusion of technical standards for derivatives transactions. Cumulatively, their intent to set forth a uniform template of parameters for a credit union's derivatives program is needed to preserve a unified approach industry-wide. Similar to the ancillary components of the Proposal discussed above, however, the Proposal's form and limits requirements of the derivatives investments themselves is costly, burdensome more stringent than necessary.

Calculation of the fair market value of the derivatives exposure on a daily basis (as well as daily monitoring of collateral) is excessive and cost-prohibitive for many credit unions. Value calculation requirements should be flexible and coincide with the volume and complexity of a credit union's involvement in derivatives. At a minimum, the NCUA should consider a bi-weekly valuation method.

Limiting a credit union's rate cap investment using the book value is counterintuitive to the goal of a properly functioning rate cap investment. When the book value is equal to its fair market value and rates are increasing (the purpose of the investment), then the cap is performing as expected and the credit union is benefiting. Why would the Proposal seek to punish a participating credit union for engaging in a derivatives transaction that is functioning as intended? The Proposal should be amended to allow for the investment limit on rate caps to relate to the lesser of current book value or original cost.

Section 703.105(b) restricts collateral to "cash, Treasury securities, fixed-rate non-callable agency debentures, and zero coupon non-callable agency debentures". The NCUA should amend this provision to allow the additional forms of collateral: mortgage-backed securities and pass-through certificates, all of which are fully guaranteed (principal and interest) by the FHLB, FNMA, Ginnie Mae or FHLMC. Such an amendment would bring the Proposal in-line with the standard ISDA Master Agreement's Credit Support Annex, which in turn, would greatly assist credit unions in their relationships with brokers/dealers.

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The Illinois Credit Union League appreciates the opportunity to respond to the NCUA's proposed rule on derivatives. Ultimately, credit unions will conduct a cost-benefit analysis and, as currently drafted, the Proposal will fail to attract credit unions to invest in derivatives. The NCUA must keep in mind the Proposal's ultimate goal, which is to incentivize credit unions to use derivatives to protect against the inevitable risks of interest rate increases, and craft a regulatory structure to allow credit unions to efficiently and safely invest in derivatives. For the reasons stated above, we believe the Proposal should be amended to reduce the regulatory constraints in order to reduce compliance burden and allow a greater number of credit unions to participate. We will be happy to respond to any questions regarding these comments.

Very truly yours,

ILLINOIS CREDIT UNION LEAGUE

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