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July 29, 2013

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

Re: Proposed Rule 12 CFR Parts 703, 715 and 741 to allow Credit Unions to engage in limited derivatives activities to mitigate interest rate risk

Dear Ms. Rupp:

Thank you for the opportunity to comment on the Proposed Rule 12 CFR Parts 703, 715 and 741 to allow Credit Unions to engage in limited derivatives activities to mitigate interest rate risk. Ent is a $3.8 billion credit union and we are one of the top mortgage lenders in the markets we serve. We currently participate in the Pilot Program, holding $60 million notional in interest rate caps to mitigate interest rate risk and follow hedge accounting rules. The following comments and recommendations are based on our knowledge experience.

We applaud the NCUA for proposing a rule which will allow Credit Unions access to another key interest rate risk management tool, and we generally support such a rule. However, we do have several concerns with the Proposed Rule and urge the Board to consider some changes before making the rule final.

Section 703.102 Permissible derivatives transactions - As part of its regulator approved strategy, a credit union may only purchase interest rate caps or enter into interest rate swap transactions that are:

> *We suggest adding interest rate floors. In the current interest rate scenario, most institutions will seek to mitigate interest rate risk for rising rates, but a time may come when select institutions will seek to mitigate interest rate risk in a declining rate scenario. Interest rate floors would be an appropriate addition to the tools in the current proposal.*

(g) Interest rate swaps that do not have fluctuating notional amounts.

> *Consider allowing amortizing notional amounts, as this may be useful in managing specific pools of mortgages. Additional risk to the credit union is minimal.*

Section 703.103 Eligibility

(a) A credit union may apply for Level I or Level II derivatives authority if it meets the following criteria:

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(a)(3) It has assets of at least $250 million, as of its most recent call report.

Because credit unions need to apply for derivatives authority and the decision will be made on a case by case basis, we do not think it is necessary to limit asset size. A credit union of a smaller size could have need of such tools.

Section 703.105 Collateral requirements for operating a Level I or Level II program.

(b) A credit union may only accept collateral to secure a derivatives transaction that is permissible for a credit union to hold as enumerated in the Federal credit Union Act, subpart A of this part, and its investment policies. Acceptable collateral is limited to cash, Treasury securities, fixed-rate non-callable agency debentures, and zero-coupon non-callable agency debentures.

We suggest the addition of agency mortgage-backed pass-through securities from one of the following: Federal Home Loan Bank (FHLB), Federal National Mortgage Association (FNMA), The Government National Mortgage Corporation (Ginnie Mae) or the Federal Home Loan Mortgage Corporation (FHLMC).

(d) Daily, a credit union must be collateralized for all transactions to at least 100 percent of the transactions, based on the risk of the collateral.

(e) A credit union must set threshold amounts to zero.

Requiring 100 percent collateralization and zero threshold amounts is burdensome as it creates the potential for daily transfers of $100 or more to and from counterparties. We recommend setting the threshold amounts at $200,000.

Section 703.106 Counterparty requirements for operating as a Level I or Level II program.

(d) A credit union must analyze counterparty credit risks, including, but not limited to: counterparty exposures, concentrations, credit exceptions, and nonperforming contracts. The credit union's board of directors must receive monthly, detailed reports addressing aggregate counterparty credit exposures.

We agree that credit unions must perform ongoing analysis of counterparty risk, but we strongly disagree with the monthly reporting requirement. This becomes very cumbersome to staff and the Board. We suggest the language be changed to require semi-annually rather than monthly.

703.107 Reporting requirements for operating a Level I or Level II program. At least monthly, a credit union's senior executive officers must deliver to the credit union's board of directors, separately or as part of the standard funds management or asset/liability report, a comprehensive derivatives report. At a minimum, this report must include:

We recommend that the reporting requirements for all subparts of this section be no more frequently than quarterly.

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Section 703.108 Systems, processes, and personnel requirements for operating a Level I or Level II derivatives program.

(a)(3) Qualified derivatives personnel. To engage in derivatives transactions with Level I authority, a credit union must have knowledgeable and experienced employees that, except as provided in Section 703.110(f) of this subpart for Level II authority, 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.

It will be difficult for most credit unions seeking derivative authority to meet this experience requirement. Most credit unions may only enter into a handful of derivative transactions over the course of several years. We recommend taking a page from the Member Business Lending regulations (Section 723.5) that also require experience but that experience requirement can be meet by the use of a third party, such as another credit union or a service provider.

We also recommend the experience required be modified to simply state experience in capital markets and advanced interest rate risk analysis and modeling.

(b)(3) Internal Controls Review. 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.

Requiring a third party to perform an audit of internal controls is a bit excessive. We recommend the review process can be completed by in house internal audit functions. We agree the idea of an annual review of controls is practical, but requiring a third party increases the cost of managing derivatives programs and will be one more deterrent to credit unions.

(b)(5) Legal Review. Before executing any transactions under this subpart, a credit union must receive a legal opinion from qualified counsel stating that the credit union's ISDA agreements are enforceable and that the credit union is complying with applicable laws and regulation relating to operating a derivatives program. Qualified counsel means an attorney with at least five years of experience reviewing derivatives transactions. A credit union must also ensure any counterparty is authorized to enter into such transactions.

Considering that the ISDA agreements are very standardized, requiring five years' experience for legal counsel is excessive. We recommend that the legal experience required be consistent with the experience required for the audit firm completing the financial statement audit, which is two years. (Refer to Section 703.108 (b)(4))

Section 703.109 Specific Level I limits and requirements – A credit union with Level I derivatives authority must comply with the following specific 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 transaction to 100 percent of net worth.

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(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.

(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 set forth in items (a) through (d) of this section could preclude a credit union from executing additional hedging transactions either because the limit was unproductively low or market value fluctuations have pushed the credit union beyond the limit.

(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.

These average life time frames seem arbitrary and unfounded. We recommend you extended the average life to ten years or more.

Section 703.110 Specific Level II limits and requirements

(a) For a credit union approved only to enter inter interest rate swaps, NCUA will establish the aggregate notional amount of its interest rate swap transactions at an amount not to exceed 250 percent of net worth.

(b) For a credit union approved only to purchase interest rate caps, NCUA will establish the aggregate book value of its interest rate cap transactions at an amount not to exceed 25 percent of net worth.

(c) For a credit union approved to transact interest rate swaps and interest rate caps, NCUA will establish the appropriate cumulative limit not to exceed individual limits in paragraphs (a) and (b) of this section.

(d) The aggregate fair value loss of all swap positions into which the credit union has entered cannot exceed 25 percent of net worth.

Limits set forth in items (a) through (d) of this section could preclude a credit union from executing additional hedging transactions because the limit was unproductively low or market value fluctuations have pushed the credit union beyond the limit.

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

As with Level I limits on average life, we feel the proposed restrictions are too short. For Level II, we recommend the average life be fifteen years or more.

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(f) The qualified derivatives personnel described in Section 703.108(a)(3) must have at least five 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.

As stated in our response to Section 703.108(a)(3), we support the notion that the experience does not have to be in house. We support the in house experience requirement for a Level II, but feel five years is too restrictive; we recommend three years for Level II.

Section 703.114 Pilot program participants and FISCUs with active derivatives positions.

(a) A credit union that, as of January 1, 2013, is holding derivative under NCUA's derivatives pilot program or applicable state law must comply with the requirements of this subpart, including the application procedures, within 12 months from the effective date of this subpart. During the 12-month interim period, the credit union may continue to operate its derivatives program in accordance with its pilot program terms and conditions or applicable state law.

Pilot program credit unions should be grandfathered from the application process. They should be given twelve months to bring their program into compliance with the requirements of this subpart in order to conduct future transactions. If the credit union has no intent of future derivatives transactions, they should be allowed to hold their existing positions under the terms and conditions of its pilot program.

It would be financially burdensome for credit unions to exit their derivatives positions just because this subpart is effective. NCUA has been comfortable with their actions under the pilot program, therefore no additional risk would result if they are allowed to hold existing positions.

Application fees

We disagree that an application fee and ongoing additional annual supervisory fee be required for credit unions wishing to establish a derivatives program. The use of derivatives is common practice for our bank counterparts. Based on Table 2 - Capacity for Derivatives Based on Bank Use Rates included in your proposed rule, on page 27, shows that banks between $1 billion to $5 billion, 57% of them currently use derivatives. Of banks over $5 billion, 83% use derivatives. It is unthinkable for our regulatory body to charge a fee to allow credit unions to reduce interest rate risk with a tool that is commonplace in the banking industry.

This fee creates a precedent that could expand to other areas and stifle new products and strategies utilized by credit unions to serve the members for which they were created. It is the responsibility of our regulator to remain current with training on products, services and strategies used by financial institutions to remain a viable option for our members.

Cost Estimates

We strongly question the cost estimates provided in the Board Action Memorandum dated May 7, 2103. Table 1 and Table 2 outline the projected cost to the NCUA and is the basis for the

application fee and annual supervision fee. The estimate itself is excessive relative to the complexities of the instruments to be allowed in the proposed regulation. A smattering of support is provided for the cost estimates but true logic and rationale is missing.

The costs of this proposed program triggers the following considerations: NCUA allows credit unions to invest in CMOs and to make/hold commercial loans. Both of these activities add risk to the balance sheet and to income, yet no additional application fees or annual supervisory fees were levied on those participating credit unions. Why then, would NCUA levy exorbitant fees to credit unions who seek to reduce risk on their balance sheet and reduce risk to income by engaging in the most basic and conservative derivative activity? The agency's approach is illogical in this respect. Furthermore, the restrictions and cost in the proposed regulation is an unmistakable deterrent to many, otherwise receptive credit unions.

Yes there will be additional cost associated to the NCUA for overseeing a derivatives program, but there are added costs in regulating any new activity allowed for credit unions. Allowing the use of derivatives will help reduce interest rate risk in the industry thereby reducing risk to the share insurance fund.

Thank for allowing us to provide comments and appreciate the opportunity.

Sincerely,

MJ Coon
Executive Vice President & Chief Financial Officer

Dan Leclerc
Director of Finance

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