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July 29, 2013

Mary Rupp
Secretary to the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314
regcomments@ncua.gov

Re: Washington State Department of Financial Institutions (WDFI)
Comments on NCUA Proposed Rule on Derivatives
78 FR 32191-01 – RIN 3133-AD90

Dear Ms. Rupp:

The Washington State Department of Financial Institutions, by and through its Director of Credit Unions ("WDFI"),[1] submits the following comments in response to the proposed changes by the National Credit Union Administration ("NCUA") to NCUA Rules and Regulations, 12 C.F.R. Parts 703, 715, and 741, related to derivatives transactions (the "Proposal").

1.0 Background on WDFI

WDFI is the primary prudential regulator of sixty-two (62) federally insured state-chartered credit unions ("FISCUs") with aggregate assets of $32.9 billion[2]. Of these, BECU is our largest FISCU with assets of $11.6 billion, making it the fourth largest credit union in the United States and the largest depositary institution chartered in Washington State.[3]

While WDFI examines and supervises FISCUs through its Division of Credit Unions, it is important to note that WDFI is a combined and integrated state agency that also regulates state-

[1] WDFI, by and through its Division of Credit Unions, regulates federally insured state-chartered credit unions in Washington State.

[2] The number of FISCUs and their total assets is as of March 31, 2013.

[3] Sterling Bank, WDFI's largest regulated commercial or savings bank, has only $9.25 billion assets as of December 31, 2012.

chartered commercial banks, savings banks, savings associations and non-depositary trust companies[4] (Division of Banks), non-depositary mortgage lenders, servicers and brokers, consumer lenders, and money services businesses (Division of Consumer Services), and issuers of private placement equity, debt securities, and derivatives products (including certain mortgage-backed derivatives), securities and derivatives broker-dealers, investment advisers, and franchisors (Division of Securities). Operating collaboratively among its divisions, WDFI has the capability of exercising the sovereign authority of the State of Washington to both determine the scope of and prudently regulate derivatives transactions by Washington State-domiciled FISCUs. Moreover, WDFI has demonstrated that capability in (1) its historic role of regulating the local securities markets, (2) its prudential examination of the investments made by all of the depositary institutions (banks, savings banks and credit unions) it regulates, (3) its supervision of the prudential character of investments made by its regulated trust companies on behalf of settlors and beneficiaries,[5] and (4) its comprehensive derivatives-related statutory amendments and rulemaking for state-chartered banks and savings banks to conform to Section 611 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").[6]

2.0 Introduction

The Proposal would grant a new authority to federal credit unions ("FCUs") to engage in certain limited derivatives transactions. With respect to federally insured state-chartered credit unions ("FISCUs"), the proposed rule would grant no new authority. However, it seeks to limit the historic authority of the states to permit FISCUs to engage in derivatives transactions. In proceeding with its protracted derivatives rulemaking notice, NCUA has not provided FISCUs, state regulators and their respective trade organizations with proportional or adequate notice that NCUA would eventually seek to preempt state law.

WDFI concurs with NCUA's overall motivation for the Proposal. Credit unions engaging in derivatives transactions should have in place appropriate experience, policies, procedures, controls, and oversight in order to manage a derivatives transactions program. WDFI also agrees with NCUA that some derivatives transactions programs, if unsafely managed, could pose a material risk to the National Credit Union Share Insurance Fund ("NCUSIF"). However, prudently managed derivatives transactions programs have been shown to significantly mitigate interest rate risk on a credit union's balance sheet and reduce risk to the NCUSIF. WDFI believes that it is capable (along with its sister-state regulators) of competently supervising a wide range of derivatives transactions in FISCUs. Many state credit union supervisors — including, as noted

[4] By way of example, WDFI is the sole prudential regulator of Russell Trust Company, an affiliate of Russell Investments Inc. (headquartered in Seattle), which is the largest "manager" of mutual fund managers in the world. Russell Trust Company has over $23 billion in managed fiduciary assets, the prudential character of which is regularly examined by WDFI. To put the significance of this fact in perspective, the fiduciary asset size of this single state-regulated entity equals or exceeds the aggregate assets of all FISCUs regulated by WDFI.

[5] WDFI's regulates the prudent investment standards of non-depository trust companies and the trust departments of state-chartered banks and savings banks through RCW 30.04.050(1)(a), RCW 32.08.157, RCW 32.08.210, RCW 32.08.215, and Chapter 11.100 RCW, which is Washington State's version of the Uniform Prudent Investment Act for fiduciary trustees.

[6] 111 Pub. L. 203, sec. 611; 12 U.S.C. § 1828(y). WDFI's implementation of Section 611 of the Dodd-Frank Act is contained in RCW 30.04.111 (as amended by 2013 c 76 s 3, Washington State Legislature) and Chapter 208-512A, Washington Administrative Code (Limits on Loans and Extensions of Credit for Commercial Banks and Savings Banks).

above, WDFI —are part of combined agencies regulating banks, trust companies, asset managers, investment advisors, international currency traders, and securities (equity, debt, and derivatives) issuers seeking registration or exemption. This state experience, coupled with the historic independence of the states to determine appropriate investments for FISCUs, requires that NCUA make a compelling case for preempting state authority in this area. Respectfully, NCUA has not made such a case.

WDFI believes there is a marked lack of proportionality between (1) all of the requirements, costs and burdens NCUA would impose for engaging in derivatives transactions as a risk mitigation tool and (2) the usefulness of the simple and common interest-rate "swaps" and "caps" permitted by the Proposal. In addition, the Proposal also raises concerns about the cooperative system and the allocation of risk.

3.0 Preemption

3.1 Unprecedented Undermining of State Authority as to Derivatives Regulation. In WDFI's reading of the Proposal, it would seek to preempt the authority of the states, acting through their legislatures and state agencies, to determine whether and on what basis FISCUs may engage in derivatives transactions. The Proposal (as currently written) would conflict with the Washington State Credit Union Act[7] and the credit union-related portions of the Washington Administrative Code,[8] which authorize Washington's FISCUs to engage in investment activities (including derivatives transactions) subject to *state* approval and regulation. The Proposal thus seeks to strip Washington State of some measure of its sovereign authority and subject all Washington FISCUs to one-size-fits-all federal requirements despite WDFI's demonstrated ability and sophistication to make these determinations regarding the character of FISCUs over which it (and not NCUA) is the primary regulator with a better understanding than NCUA of what is prudent for Washington FISCUs. Moreover, NCUA's proposed blanket preemption of state law runs contrary to the intent of Congress when it considered how best to handle the regulation of derivatives transactions by *state*-chartered banks and savings banks. Indeed, in Section 611 of the Dodd-Frank Act, Congress made it clear that the state's retained authority over the scope of regulation of state-chartered bank and savings derivatives, conditioned only upon the state's lending limit laws.[9] The Proposal's preemption of existing state derivatives authority would be a substantial (and we believe unwarranted) departure from the common regulatory scheme among state and federal regulators regarding derivatives transactions — and with no documented justification for such a drastic measure.

3.2 No Documentary Support for Need for Federal Preemptive Standards. WDFI and its Director of Credit Unions, a board member and past president of NASCUS, are unaware of any FISCUs whose derivatives transactions (if any) are not regulated by state credit union

[7] RCW 31.12.436.

[8] WAC 208-436-010.

[9] 111 Pub. L. 203, sec. 611; 12 U.S.C. § 1828(y).

supervisors. Rather, the Proposal simply makes an *undocumented* assumption that there is unregulated FISCU derivatives activity.

3.3 Current "Federal Parity" Statutes Permit a Balanced, State-Option Approach to Regulation of Derivatives. While most states currently do not authorize derivatives transactions for their FISCUs, this does not compel a solution that NCUA should preempt the field. In the states that currently allow some measure derivatives transactions for their FISCUs (Washington State), the activity is supervised by the state regulator (in our case, WDFI, with its collaborative expertise as a combined agency as noted above). Either way, however, derivatives transactions would be regulated and supervised. Where state law does not authorize derivatives transactions for FISCUs, the FISCU could nonetheless invoke the state's federal parity statute to assume the powers of FCUs once NCUA authorized derivatives transactions for FCUs. In that case and for those states, then, derivatives transactions would be regulated in an identical matter as the Proposal. However, in states that independently permit derivatives transactions by FISCUs, the state regulatory scheme would prevail. Accordingly, the portion of the Proposal that seeks to preempt state is unnecessary. Rather, a balanced, state-option approach as noted above provides the best solution and, as we have stated above, is consistent with the overall intent of Congress when it considered state regulation of derivatives transactions, leaving regulation by the states in place.

3.4 NCUA's Current Rules Would Permit Treatment of State Derivative Authority as "Non-Conforming" Investments with "Reserves". Under current NCUA Rules, the NCUA may treat state derivatives authority that does not conform to the risk mitigation aspects of the Proposal as a "non-conforming" investment and require a "reserve." This approach would make more sense than preempting state laws without any demonstration that they have posed, or currently pose, a material risk to the NCUSIF.

3.5 WDFI and Many Other State Regulators Are Combined and Collaborative Agencies with the Expertise to Regulate the Scope and Manner of Derivatives Transactions. As we have indicated above, WDFI is one of many state credit union supervisors which are part of a combined and collaborative agency that regulates banks, savings banks, savings associations, trust companies, and securities, and which appreciate and have heretofore regulated for risk in derivatives transactions in a variety of contexts, both simple and complex.[10] Should the day come that WDFI's largest FISCUs would be permitted by WDFI to engage in more complex or "exotic" derivatives transactions, it would only be on a basis that WDFI could assure (1) the same level of safety and soundness as its regulation of state-chartered banks and savings banks while (2) maintaining fairness and competition as between state-chartered banks and savings banks and FISCUs of similar size, market, and consumer products. In that event, however, WDFI

[10] In the context of state-chartered community banks and savings banks and FISCUs, derivatives transactions programs have frequently included interest-rate swaps as a participating member of one's district Federal Home Loan Bank to slightly-more-complex (but still manageable) hedging of interest-rate risk associated with "forward commitments" to the secondary market of one's residential mortgage loan pipeline. These relatively simple derivatives products, to the extent that they are issued by third party issuer-facilitators but perceived as "extensions of credit" by the examined institution itself, comprise most of what WDFI believe state-chartered community banks, savings banks, and FISCUs either engage in now or would undertake if they were authorized by WDFI to do so. As for more complex forms of derivatives transactions in the depositary institution context, WDFI has seen very little (if any) of this kind of activity by its state-chartered banks and savings banks, let alone its FISCUs.

has the expertise as a combined and collaborative agency to assure prudent investment and allocation of risk in a range of derivatives transactions, including, for example, investment in foreign currency exchange[11] and more complex asset-backed securities ("ABS") transactions.[12] State regulators that allow their FISCUs to engage in derivatives transactions are confident of their ability to regulate the activity, and in many cases may have far more experience than NCUA in this regard. While WDFI respects NCUA's motivation for wanting to see that credit union derivatives transactions are regulated, it may be a fair statement that some combined state agencies regulating FISCUs (WDFI included) could have even more expertise than NCUA to regulate FISCUs engaging in derivatives transactions.

3.6 NCUA Should Await Accumulated Data on Derivative Transactions by FISCUs. WDFI believes that it would be more prudent for NCUA to await the development of accumulated data on FISCU derivatives transactions activity prior to revisiting and having a more educated dialogue with the states about the regulation of derivatives as between NCUA and state credit union supervisors.

3.7 It Is Unclear What NCUA Seeks to Preempt. While it appears that NCUA does seek to preempt state authority to regulate FISCU derivatives transactions, it is unclear *exactly* what state authority NCUA seeks to preempt. Does NCUA intend to preempt all state authority with respect to derivatives powers? Does it intend to preempt any state "swap" or "cap" authority, but not other derivatives-related powers? It appears as if this confusion is related to NCUA not having provided FISCUs with their own share insurance rules concerning the NCUSIF. There is a conflict between the preamble accompanying the Proposal and the actual language of the proposed rule.

3.7.1 Proposal Preamble. The preamble to the proposed rule implies that the purpose of the rule with respect to all federally insured credit unions is to limit derivatives activity to that which the rule would allow for FCUs: simple "swaps" and "caps." Subsection C of the Preamble states that the rule would apply to all FISCUs without distinguishing parts of the rule that might be FCU-specific. Subsection E of the Preamble declares: "As stated above, this proposed rule limits permissible derivatives transactions for both Level I and Level II to interest rate caps and interest rate swaps." However, the text of the proposed rule, as related to FISCUs, is controlled by proposed 12 C.F.R §741.219. It declares:

> § 741.219 Investment requirements.
>
> (a) Any credit union which is insured pursuant to title II of the Act must adhere to the requirements stated in part 703 of this chapter concerning transacting business with corporate credit unions.
>
> (b) Derivatives. Any credit union which is insured pursuant to Title II of the Act and permitted by its state law to engage in derivatives must follow the requirements of subpart B of part 703 of this chapter.

[11] WDFI has expertise in the FOREX markets through its comprehensive regulation of money services businesses (Division of Consumer Services) and in its registration of derivatives issuers (Division of Securities).

[12] WDFI has expertise in a wide range of ABS transactions through its registration of derivatives issuers (Division of Securities).

3.7.2 Conflict between 12 C.F.R. Parts 703 and 741. New Subpart B of 12 C.F.R. Part 703 contains the proposed requirements for conducting "swap" and "cap" transactions. However, in no place does Subpart B prohibit engaging in *other* derivatives transactions. This prohibition is found in proposed 12 C.F.R. §703.14 — a provision which does not apply to FISCUs.[13] Yet there is no reference to 12 C.F.R. §703.14 in 12 C.F.R. Part 741. Accordingly, because the proposed rule would only add a reference to Subpart B in the FISCU-only 12 C.F.R. Part 741, NCUA has not actually prohibited non-"swap" and non-"cap" *other* derivatives transactions for FISCUs. Rather, NCUA has only limited what FISCUs may do with respect to "swaps" and "caps." Therefore, NCUA ought to clarify to what extent it intends to *actually* preempt state law.

4.0 The Proposed Eligibility Requirements

WDFI agrees that FISCUs seeking derivatives transactions authority must have sufficient expertise to safely manage a derivatives transactions program. However, several of the eligibility requirements contained in the Proposal are far too stringent.

4.1 The $250 Million Asset Threshold. WDFI opposes an asset threshold as an eligibility requirement. In view of all the other requirements in the Proposal, WDFI believes the amount of this asset threshold is arbitrary. Once regulators have established their quality expectations for management of a derivatives transaction program, any FISCU (or, for that matter, FCU) able to comply with those expectations should be allowed to engage in derivatives. WDFI finds it interesting that NCUA's interest-rate risk rule, which forms the underlying basis for motivating engagement in derivatives transactions, applies equally to credit unions either above or below the Proposal's $250 million asset threshold. Therefore, WDFI finds no logical basis for the proposed "asset threshold" requirement.

4.2 Experience Requirements. Requiring enumerated experience for certain credit union activities is not a new concept. Currently, FISCUs engaged in member business lending may be required to employ someone with a minimum amount of experience. However, the scope of this Proposal's experience requirement is of a different order of magnitude. Under the Proposal, nearly all of a credit union's executive employees and board of directors' members would be required to have derivatives expertise. This would be in addition to the stringent requirements for the numerous employees the rule requires for segregation of duties. Quite

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[13] 78 Fed. Reg. 32194, 32195 (May 29, 2013). Proposed 12 C.F.R. §703.14 declares:

> §703.14 Permissible investments.
> * * * * *
> (k) Derivatives. A federal credit union may only enter into in the following derivatives transactions:
> (1) Any derivatives permitted under § 701.21(i) of this chapter, § 703.14(g), or subpart B of this part;
> (2) Embedded options not required under generally accepted accounting principles (GAAP) adopted in the United States to be accounted for separately from the host contract; and
> (3) Interest rate lock commitments or forward sales commitments made in connection with a loan originated by a federal credit union.

simply, it is unclear how credit unions, other than a few FISCUs already engaged in derivatives pursuant to state law or rule, could possibly meet these requirements in a realistic manner.

4.2.1 Initial and Annual Training Requirements for Board Members. While it is important that the credit union's directors be provided with some education about the nature of derivatives transactions and a credit union's interest rate risk mitigation strategy, annual education requirements for the entire board are overly burdensome, particularly given the very limited nature of permitted transactions and the other restrictions in place that mitigate transactional risk. Board members should have some understanding of how derivative transactions can mitigate interest rate risk and the risks associated with such activities, but the level of expertise needed to understand largely *simple* interest-rate "swaps" or interest rate "caps" hardly justifies an annual training requirement.

4.2.2 Skill of Executive Officers and Management. The Proposal requires that senior executive officers and management staff have the requisite skill set before engaging in derivatives transactions. While some level of knowledge and understanding is necessary, it is difficult for all senior executive officers to acquire the necessary detailed experience, particularly when credit unions have historically been prohibited from engaging in derivatives transactions. Even some senior executive officers with direct responsibility for the derivative transactions program are unlikely to be able to acquire experience with derivative transactions before the credit union actually engages in such transactions. The rule should clarify that senior executive officers responsible for directing a derivatives transactions program acquire the appropriate level of education, but refrain from requiring any set level of *prior* experience in derivative transactions.

4.2.3 Employed Staff Experience. The Proposal's required experience for staff employed in the derivative program is too broad. Given the requirement for separation of duties, not all staff involved in a credit union's derivatives transactions program need to have experience in all of the job functions described in 12 C.F.R. §703.108(3). For example, staff responsible for actual execution of the derivative transactions need not demonstrate that they can oversee appropriate accounting and financial reporting for such transactions. It is uncertain from the Proposal what type of training NCUA will require in order for staff employees of a credit union to demonstrate particular competencies. This uncertainty imposes additional and unnecessary burdens on a credit union's regulatory cost in applying for derivatives transaction authority.

4.3 Legal Opinions. While NCUA should be encouraging the responsible use of derivative transactions to mitigate interest rate risk, the "legal opinion" requirement, as proposed, is overkill and would be counter-productive in practice. The Proposal would require that a credit union obtain a legal opinion from qualified counsel before executing *any* derivative transactions. This requirement seems to require both (1) an opinion as to the enforceability of a derivative transaction agreement and (2) a separate opinion that a credit union is complying with all applicable laws and regulations related to the derivatives transactions program. Attorneys, despite having the requisite skill-set, are not necessarily willing and able to provide formal legal opinion letters about such matters. If those opinion letters are intended to be third-party opinion letters upon which the NCUA may rely, they will be both expensive and heavily qualified, even as to enforceability of transaction agreements. The unwillingness of an attorney to provide a satisfactory legal opinion letter should not prevent the credit union from engaging in the transaction if its own internal counsel and/or experienced staff and management properly analyze the legal and compliance requirements. Further, if the NCUA intends that the credit union obtain a separate opinion for each of what should be very similar transactions, subsequent opinion letters will not likely add any meaningful risk mitigation. Many of the derivatives products available to banks and credit unions are issued and/or facilitated by third parties (e.g., large national bank affiliates and even district Federal Home Loan Banks, of which credit unions are often members). Even though as a matter of law it is the credit union that would be making "extensions of credit" in the use of these products, it is the third-party issuer-facilitators who are making representations in the marketing of these products. WDFI believes that it could be an unfair and prohibitive burden for smaller credit unions with no in-house staff counsel to obtain legal opinions as a prerequisite to entering into very simple, standard derivatives transactions (e.g., many interest-rate "swaps"). Currently, WDFI does not mandate a "legal opinion" requirement for state-chartered banks and savings banks engaged in derivatives transactions. Nor do we believe that the Office of the Comptroller of the Currency mandates such a requirement for national banks or federal thrifts. WDFI therefore believes that the rigidity of this requirement would be unfair to its FISCUs in relation to Washington State-chartered banks and savings banks. WDFI believes that if there is to be a "legal opinion" requirement at all (which WDFI does not recommend be mandated), it should not be limited to outside, independent legal counsel. Moreover, an outright requirement that an attorney have a minimum of five years' experience in derivatives transactions as a prerequisite for issuing a legal opinion to a credit union is burdensome and impractical. If a "legal opinion" requirement is to be mandated at all, it should simply say that a credit union must obtain an opinion from an attorney qualified to act in matters involving the derivatives transactions for which s/he is rendering an opinion.

4.4 The CAMELS Rating Component of Eligibility. Proposed 12 C.F.R. §703.103 states that eligibility is contingent on a FISCU's most recent CAMELS rating from NCUA. This provision disregards the primary role of the state regulator in supervising the FISCU. The state regulator is in the best position to evaluate the suitability of the FISCU for engaging in derivatives. Moreover, WDFI does not see how deferring to a state's CAMELS rating increases any potential risk to the NCUSIF, since the CAMELS requirement is only a basic eligibility requirement and not a guarantee of regulatory approval to engage in the transactions.

5.0 The Application Process

The Proposal would require a FISCU seeking "Level I" derivatives transactions authority to submit a detailed application to its state regulator. The application must demonstrate how the credit union intends to use derivatives as one aspect of its overall interest-rate risk mitigation strategy. The credit union must also demonstrate how it plans to meet the eligibility requirements with respect to internal policies, procedures, processes, and employee experience and expertise. FISCUs seeking "Level II" authority must demonstrate that the eligibility requirements are already satisfied. In addition, NCUA suggests in the proposed rule that it might charge an application fee ranging from $25,000 to $125,000. If the state regulator approves the FISCU application for derivatives transactions authority, the application is then reviewed by NCUA for approval.

5.1 Application Fees. WDFI adamantly opposes NCUA charging FISCUs an application fee to engage in derivatives transactions. There are several reasons for this:

5.1.1 Unfair Burden. Such a fee would unfairly disadvantage all credit unions, but *especially* smaller ones. This is particularly the case when the eligibility requirements, by themselves, already ensure that managing a derivatives transactions program at a FISCU will be an expensive undertaking.

5.1.2 The Precedent Undermines the Spirit of the Cooperative System. Speaking as a leader in the affairs of NASCUS over the past several years, WDFI is of the view that the proposed fee sets a dangerous precedent. The Proposal mentions the supervisory expense of regulating derivatives and indicates that the cost might best be borne by those credit unions exercising the authority rather than the system as a whole.[14] Such a practice seems antithetical to the cooperative nature of the credit union system in general, and of the NCUSIF in particular. Moreover, the Proposal is devoid of any discussion of what distinguishes derivatives from other credit union activities that would present risk to the NCUSIF and increase the cost of supervision.

5.1.3 "Fee Parity" between FCUs and FISCUs. WDFI does not understand why NCUA's fee would be the same for FISCUs and FCUs. Given that a FISCU's application would be processed by the state regulator and that the state regulator would remain the *primary* regulator, it would seem NCUA's "cost" of administering a derivatives programs for FISCUs would be lower than for that of FCUs.

5.2 Review of Applications – Timeframe. The Proposal contains specific timeframes for NCUA's review of a FISCU's derivatives authority application after that application has been approved by the state regulator. While it is good that NCUA sets a time certain for a FISCU to expect a response, WDFI believes the timeframes for FISCUs in this regard are too long. NCUA's timeframes for review a FCU application and a FISCU application are the same. Because a FISCU submits its application first to its state regulator, it is more than likely that a FISCU will have a longer time horizon for review of their application than a FCU. Moreover, a state regulator's review of a FISCU's application before coming to NCUA should reduce the amount of time needed by NCUA to review the application, since a FISCU's application has already been *pre-screened* by the state regulator.

6.0 Managing a Derivatives Transactions Program

The Proposal has numerous, detailed provisions for managing a derivatives transactions program. In this regard, WDFI cautions NCUA about overly restrictive provisions that may stray from industry norms, particularly those that are available by contrast to state-chartered banks and

[14] 78 Fed. Reg. 32204 (May 29, 2013).

savings banks. The rationale for permitting credit unions to engage in derivatives transactions is predominantly to provide a means of offsetting interest rate risk. However, overly restricting derivatives transactions for credit unions out of an abundance of caution might render moot the very purpose for which those transactions are undertaken. Overly prescriptive requirements provide little flexibility for either regulators or credit unions to adapt to future circumstances. In this regard, WDFI believes the following elements of the Proposal related to management of a derivatives transaction program should be the subject of further discussion:

6.1 Daily Pricing of Derivatives Positions. WDFI's "derivatives rule" for state-chartered banks and savings banks does not necessarily require daily pricing of derivatives positions.[15] Proposed 12 C.F.R. §703.105 lists collateral requirements such as "acceptable collateral," "collateral levels," and "daily pricing." WDFI is not certain whether the requirement to price a credit union's derivatives' position daily is, in all circumstances, consistent with common practice.

6.2 Monthly Reporting of Credit Union Board. Proposed 12 C.F.R. §703.107 requires monthly reporting to a credit union's board. Not all states require monthly board meetings, and therefore, should amend the provision to require "regular" reporting to the board.

6.3 Limiting Activity to Various Percentages of Net Worth. "Level I" and "Level II" derivatives' authorities would contain restrictions in proposed 12 C.F.R. §703.109 and 12 C.F.R. §703.110 that limit derivatives transactions to various percentages of net worth. While credit union balance sheets vary, WDFI questions whether the total amount of transactions permitted would be sufficient to meaningfully contribute to mitigation of interest-rate risk.

7.0 Due Process: Limited Comment Period for FISCUs

NCUA states in the Preamble of the Proposal that it considered the feedback received from public comments submitted to its prior Advanced Notice of Proposed Rulemakings ("ANPRs") published on this subject.[16] Yet the most recent ANPR on the subject, published in February 2012, at no point indicates NCUA's intentions to extend the rulemaking to include FISCUs. While FCUs and their interests have had extended opportunities to submit comments to NCUA concerning the principles involved in regulating derivatives, FISCUs, state regulators and their respective trade organizations have had a substantially more limited opportunity to do so. NCUA should have communicated in the February 2012 ANPR its intention to break with the historic precedent of deference to state law. Had it done so, NCUA would have benefitted prior to now from a more complete discussion of the afore-mentioned preemption arguments. This is a

[15] Chapter 208-512A WAC. WAC 208-512A-007(13) contains a definition of "effective margining agreement" that denotes a "master legal agreement" between a bank and its derivatives counter-party that "requires the counterparty to post, on a daily basis, variation margin to fully collateralize that amount of the bank's net credit exposure to the counterparty created by the derivative transactions covered by the agreement, subject to any monetary threshold requirements as prudently determined by the bank and its counterparty." However, the only use of that term in the entire WDFI derivatives rule is in WAC 208-512A-300(8) establishes a calculation method (without daily posting) if one does not enter into an "effective margining agreement." At the time of adoption in early January 2013, this was consistent with OCC Rules for national banks and federal thrifts.

[16] 78 Fed. Reg. 32194, 32195 (May 29, 2013).

legitimate due process issue. At a minimum, if NCUA proceeds with final rulemaking, the final rules should be limited to FCUs. Preemption of state authority in this regard deserves a more deliberate, focused and full discussion that can only be achieved through a separate rulemaking process.

8.0 Concluding Remarks

For all of the reasons set forth above, WDFI believes that the Proposal is premature, over-burdensome, and over-reaching as applied to the FISCUs that WDFI regulates and, if NCUA proceeds to adoption of a final rule, should be limited to FCUs only. While WDFI respects and shares NCUA's concerns for the safety and soundness of any derivatives transactions program, WDFI believes that any federally mandated requirements of state credit union supervisors grant to them the same historic flexibility that Congress demonstrated when it re-affirmed the wisdom of the federal-state dual regulatory system in its enactment of Section 611 of the Dodd-Frank Act. This can only happen if FISCUs, state credit union supervisors and their respective trade organizations have adequate notice and full opportunity to address the merits of state authority and the lack of wisdom in attempting to preempt state law.

Respectfully submitted,

WASHINGTON STATE DEPARTMENT
OF FINANCIAL INSTITUTIONS

Division of Credit Unions

Linda K. Jekel
Director of Credit Unions