Wings FINANCIAL

July 29, 2013

Via E-Mail to regcomments@ncua.gov

Mr. Gerard Poliquin
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314–3428

Re: Wings Financial Credit Union - Comments on Proposed Rule—Derivatives

Dear Secretary Poliquin:

Thank you for the opportunity to provide comments on your Proposed Rule on the use of derivatives. Wings Financial Credit Union (Wings) strongly agrees with the NCUA that interest rate risk (IRR) poses a material risk to many, if not all, credit unions and that derivatives can be beneficial in helping to mitigate that risk. If individual credit unions employ derivatives to hedge their respective IRR exposures, overall risk to the National Credit Union Share Insurance Fund (NCUSIF) should also be reduced, as stated by the NCUA Board. However, Wings has a number of concerns regarding the current form of the proposed regulation which we believe poses many barriers to the use of derivatives as a risk mitigation tool and we respectfully submit the following comments for your consideration.

QUALIFICATIONS FOR APPROVAL

Wings agree that senior management and board members must be adequately trained and informed before engaging in the use of any new risk mitigation tool and that those with day-to-day management responsibility must have the necessary experience and expertise. However we believe that the proposed required qualifications for legal counsel are arbitrary, unnecessary and do not guarantee a desired outcome. Legal counsel's role in the process does not require specific derivatives knowledge; that knowledge rightly must be present in those managing and executing the program.

CAMEL RATINGS

We believe it is inappropriate to tie the ability to use swaps to mitigate risk to a CAMEL rating. A direct correlation between a CAMEL rating and a credit union's ability or need to utilize swaps is not readily apparent. In addition, it could be very likely that a credit union with a weaker CAMEL rating would derive more benefit from using swaps for risk mitigation than a credit union with a stronger CAMEL rating. Further CAMEL ratings, particularly the Management component, are very subjective, which diminishes their usefulness as a regulatory qualification tool.

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TOTAL POSITION LIMITS

Depending on the level of authority granted (Level I or II), the NCUA proposes limiting the amount of allowable swaps as a percentage of net worth. While setting limits is prudent, the benchmark needs to correlate with the amount of risk being mitigated by the swaps. Net Worth does not provide that correlation. In fact, setting a limit relative to net worth implies the activity is additive to risk which is the polar opposite of a well-constructed IRR hedging strategy. We believe limits, if any, should be set by each credit union's board of directors within the context of the credit union's risk profile and reviewed by regulators during the periodic examination process. It is the responsibility of each credit union's board to determine the level of risk that is acceptable for the organization. If that level is being exceeded, IRR hedges are one tool they should be allowed to employ to reduce that risk.

Additionally, limits, if any, should be based on the market value of the swaps and not the notional value.

COUNTER PARTY LIMITS

As stated above, we believe that it is appropriate for each credit union's board of directors to set limits with regards to risk, including counter party risk. Further, each credit union's credit worthiness as an organization will serve to help limit counter party risk, as counter parties will also set exposure limits based on their analysis of the credit union's fiscal soundness.

LOSS LIMITS

Placing limits on aggregate fair value losses on all swap positions at either 10% (Level I) or 25% (Level II) of net worth treats the hedging strategy as a speculative investment and ignores its use as a risk-reduction measure. If the swaps experience a loss in market value, then there should be an off-setting gain on the assets being hedged by the swaps. Swaps are used as insurance against losses in the underlying assets but appreciation of the underlying assets should not mandate disposal of the insurance. Looking at the swap only, and not the entire hedged position, ignores the use of the swap as a risk mitigation tool. This one-sided view is akin to a regulator requiring the cancelation of property insurance if no claims are incurred for the insured property. We believe the entire transaction must be examined and not merely the individual legs in isolation.

Further, we continue to believe that the authority to determine and set limits should reside with each credit union's board of directors and not the NCUA.

MATURITY LIMITS

Setting limits regarding final maturity and average life restricts the effectiveness of the swap as a risk mitigation tool. The exposure present on each credit union's balance sheet should be used to determine the appropriate final maturity and average life. For example an exposure to 30 year fixed rate mortgages can only be addressed by the use of long-dated swaps. If regulation only allows the use of short-dated swaps, neither the institution nor the NCUSIF will be helped by the institution entering into a swap. Using the "Prudent Investor" framework, it makes more sense to look at the swap, and its maturity and average life, in the context of the risk being mitigated as well as the other swap positions in the portfolio rather than an individual position.

Should it be determined appropriate to set limits on final maturities and average life, again this is a responsibility best left to individual credit union's board of directors.

DAILY MARK TO MARKET

Marking swap positions to market on a daily basis is excessive and unnecessary. Credit unions are not required to mark any other assets, including the exposures the swaps are mitigating, to market on a daily basis. We see no reason to treat swaps any differently. We believe a monthly marking would be appropriate.

MONTHLY REPORTING REQUIREMENTS

We agree that swap positions should be reported on a monthly basis as a part of a comprehensive review of the credit union's financial condition. How they are reported and reviewed should be left to the discretion of each credit union. Additionally, Wings believes that a quarterly rather than monthly calculation of NEV would continue to be sufficient should swaps be utilized. Rarely, if ever, do circumstances change over 30 days that materially impact NEV calculations making monthly reviews an unnecessary and inefficient regulator imposed burden.

While we agree that reviewing financial conditions using statements that both include and exclude swaps could be useful as a tool to determine the effectiveness and impact of the swap positions, we do not believe that this is an exercise that should be required on a monthly basis.

APPLICATION TO STATE CHARTERED CREDIT UNIONS

As a state chartered credit union Wings currently has the ability to utilize swaps as a risk mitigation tool. It is concerning that the NCUA would choose to supersede the authority of the Minnesota Department of Commerce over an activity they have determined to be a valid method to reduce not only Wings' risk profile, but as noted above that of the NCUSIF as well.

This rule would continue the NCUA's erosion on the dual charter system by needlessly preempting investment options available to federally insured state-chartered credit unions ("FISCUs"). As was done in connection with the proposed expansion of credit union service organization (CUSO) rules and with the recently-finalized loan participation rules, this proposal uses the bald assertion that the risks inherent in derivatives and their unregulated use poses significant risk to the NCUSIF as the basis for stepping over state regulators and state-promulgated regulations. The NCUA fails to provide any evidence that FISCUs' use of derivatives is unregulated or has caused any losses (or increased any risks) to the NCUSIF, and the NCUA offers no other justification for eliminating yet another distinction between state and federal charters and usurping the lawful authority of state chartering agencies. The proposed rule goes beyond prior impositions on the state regulators by placing them in a mere advisory role with respect to derivatives, leaving the ultimate determination of what is appropriate to the NCUA. Commandeering the authority of the state regulators is something that should be done only when there are no other alternatives and the risk posed to the NCUSIF is real and significant. Wings believes that neither is present in this instance and encourages the NCUA to reconsider the application of this proposed rule to FISCUs.

APPLICATION FEES

The fees proposed to seek approval are significant and create a barrier to the use of an effective risk management tool. Wings believes, and it appears NCUA does as well, that the use of swaps can be beneficial in helping credit unions mitigate IRR while also reducing risk to the NCUSIF. Even if all credit unions do not use swaps, all credit unions should benefit from the reduction of risk to the credit union system. Therefore it seems perverse to financially penalize those credit unions that choose to use swaps as a risk mitigation tool. We are aware of no other insurer – either in the private sector or governmental – who charges its insureds an additional fee for engaging in conduct that reduces the exposure of the insurer.

The fees proposed are tiered, assessing a larger fee to those credit unions seeking Level II approval. Those institutions seeking Level II approval would only seek that level if their IRR exposure could not be addressed by Level I approval. The higher fee serves as a disincentive which could lead credit unions to not seek the higher level approval leaving the NCUSIF exposed to risks which could have been mitigated. Further, credit unions that seek Level II approval are assumed to be larger credit unions that will execute more derivative transactions than Level I credit unions. However, they are also, as required by the proposed rule, credit unions that have a higher level of sophistication in dealing with derivative transactions. Therefore it can be argued that they would require less regulatory scrutiny and should be charged less, or at minimum equivalent, application fees as Level I credit unions.

Any increased costs that may be incurred by the NCUA as a result of its proposed rule should be more than offset by the reduced losses/risk on the NCUSIF. If the costs are not covered, then we would suggest that the system developed by the NCUA is unnecessarily complex and beyond what is required to manage the risk posed. In either event, we believe that requiring credit unions to pay for the privilege of engaging in desired conduct is a dangerous precedent that will ultimately weaken the credit union charter and place credit unions at a disadvantage in the marketplace.

In conclusion, while Wings believes that the use of swaps can be beneficial in helping credit unions mitigate IRR (and thereby reduce risk to the NCUSIF), we believe that the Proposed Rule is unnecessarily complex and will discourage the use of this risk mitigation tool. Rather than heavy-handedly imposing its will on state regulators, Wings believes that the NCUA should approach the matter as other financial regulators have – by authorizing the investments for federally-chartered credit unions and reviewing the use of the investments as a part of its annual examination process. Adopting onerous regulations that will ultimately preclude the use of a valuable risk reduction tool does not provide any protection for the NCUSIF (nor does it enhance the value of the credit union charter), and Wings respectfully requests that the NCUA reconsider its approach.

Respectfully,

Timothy A. Keegan

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