OHIO CREDIT
UNION LEAGUE

July 29, 2013

VIA E-mail: regcomments@ncua.org

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

RE: Derivatives
12 CFR Parts 703, 715, and 741
RIN 3133–AD90

Dear Mr. Poliquin:

The Ohio Credit Union League ("OCUL") appreciates the opportunity to comment on the National Credit Union Administration's ("NCUA") Proposed Regulation on Derivatives.

OCUL is the trade association for credit unions in Ohio and advocates on behalf of Ohio's 356 federal- and state-chartered credit unions, serving 2.7 million members. The comments reflected in this letter represent the recommendations and suggestions that OCUL believes would be in the best interest of Ohio credit unions.

Background

The NCUA Board issued a proposed rule that amends its investment rule to allow federal credit unions ("FCU") and federally insured, state-chartered credit unions (FISCU), authorized by their state laws, to use derivatives to mitigate interest rate risk ("IRR"). The proposed rule limits credit unions' authority only to derivatives instruments known as interest rate swaps and caps. The proposal contemplates Level I and Level II derivatives authority, with Level II authority giving credit unions more flexibility but with stricter requirements. Credit unions must apply to the NCUA for permission to conduct derivatives transactions, which requires credit unions to demonstrate the need and ability to conduct derivatives transactions in compliance with the proposed rule.

Commentary

OCUL applauds NCUA's efforts to expand the options available to federal credit unions to mitigate interest rate risk to include the use of derivatives. However, OCUL has some serious reservations about the specific provisions of this rule, in particular,

- the incursion into the authority of state regulators by the inclusion of state-chartered, federally-insured credit unions under the proposal;
- the imposition of additional fees for participation in derivatives programs;

- the requirements for expertise of credit union personnel and prohibition of reliance on external expertise in review and administration of derivatives programs; and
- the asset-based thresholds for engaging in derivatives programs.

Incursion on the Authority of State Regulators

NCUA proposes that these proposed rules apply to all federally-insured credit unions, both federally- and state-chartered. Federally-insured, state-chartered credit unions would be required to comply with the NCUA rule or the derivatives rule issued by the state, but only if the state rule is more stringent than NCUA's.

Although framed as an expansion of the interest-rate risk mitigation tools made available to credit unions, in reality, this proposal would limit the existing authority to use derivatives granted to many state-chartered, federally-insured credit unions by their state examiners. This extension is an overreach of NCUA's regulatory authority, damaging the dual chartering system. By minimizing the state regulators' ability to set other standards, it marginalizes one of the reasons a credit union might wish to operate under a state charter.

OCUL therefore opposes the portions of this rule which extend NCUA's authority by allowing it to set minimum standards applicable to state-chartered credit unions, damaging the dual chartering system.

Fees for Application and Supervision

NCUA is considering instituting a fee structure for those credit unions that apply for derivatives authority. This is the first time that NCUA has proposed charging credit unions fees in this manner and might set a precedent for application and examination fees for other credit union activities.

NCUA states that the agency's application review process and ongoing supervision is labor and resource intensive. Further they state "[r]ather than pass this cost on to the credit union industry as a whole, the Board believes it may be prudent to pass this cost directly to the credit unions seeking approval." NCUA is considering a Level I application fee with amounts starting at $25,000 and a Level II application fee with amounts ranging from $75,000 to $125,000, based on the complexity of the application. The fees would be updated in periodic guidance based on the evolving costs of processing applications.

OCUL strongly opposes the imposition of application and supervision fees in order for credit unions to gain derivatives authority. Such fees may create additional unnecessary barriers for credit unions seeking to use a valuable tool to mitigate interest-rate risks.

Additionally, fees should not be charged a la carte for adding services, investment activities, or other products that have been duly authorized by NCUA. The proposed fee schedule in this rule sets a bad precedent that may stifle future innovation by credit unions.

Expertise Requirements

NCUA's proposed rule details experience requirements for credit union staff and board of directors. The board must receive initial and annual training to provide general understanding of derivatives. The credit union's senior executive officers must have sufficient knowledge and experience to understand, approve, and provide oversight for the derivatives activities commensurate with the complexity of the derivatives program. These individuals must have a comprehensive understanding of how derivatives fit into the credit union's business model and risk management process.

Additionally, to engage in derivatives transactions with Level I authority, the credit union must have knowledgeable and experienced employees that 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, a risk management advisory practice, or a financial regulatory organization. Staff must also have the demonstrated expertise in the statement of financial condition analysis described in proposed §703.107(d). Level II authority requires employees with at least five years of experience. Qualified derivatives personnel must have the ability to perform the following requirements:

- Asset/liability risk management.
- Accounting and financial reporting.
- Trade execution and oversight.
- Credit, collateral, and liquidity management.

Credit unions may not rely on outside expertise in managing a derivatives program.

OCUL urges NCUA to reconsider the expertise requirements for engaging in a derivatives program. NCUA should allow credit unions to meet experience requirements with employees, contractors, or through service providers when the qualified person is not in a position to profit from the transactions. The costs and the availability of experienced derivatives people may preclude many credit unions from engaging in derivatives.

Asset-Based Thresholds for Engaging in Derivatives Programs

A credit union must have $250 million or more in assets to be eligible for derivatives authority. NCUA states that IRR is more prevalent in credit unions with assets over this threshold level, which is the reasoning for setting the threshold at this amount. NCUA also indicates that most credit unions with assets below this threshold do not have sufficient resources to conduct a derivatives program. Also, credit unions with assets below the threshold might not have access to counterparties.

OCUL opposes setting an arbitrary asset-based threshold for engaging in derivatives. Although there may be some barriers for smaller participants, those smaller credit unions also face interest-rate risk in today's economic environment. If they can meet the other derivatives rule requirements, they should be granted derivatives authority. Standards for engaging in derivatives should be based on safety and soundness and the ability to manage risks, not on an artificial arbitrary rule.

Conclusion

NCUA's proposal to allow federally-insured credit unions to engage in derivatives is a welcome addition to the tools allowing credit unions to mitigate interest-rate risk. However, OCUL has some serious concerns about the rules as proposed.

The rule's application to federally-insured, state-chartered credit unions is an overreach by NCUA into the purview of state regulators without a showing that the state regulators' own processes of approving use of derivatives is a threat to the safety and soundness of the National Credit Union Share Insurance Fund. Additionally, the proposed rules place several barriers for credit unions wishing to start a derivatives program – fees for application and supervision, staff expertise requirements, and asset-based thresholds, among other concerns. Accordingly, OCUL urges NCUA to amend its proposed rule, keeping in mind that rules should be balanced in order to maintain the safety and soundness of the credit unions involved and share insurance fund while allowing credit unions the flexibility of innovating their practices to keep pace with the rapidly-changing economic environment.

The Ohio Credit Union League appreciates the opportunity to provide comments on the NCUA's proposed rule on derivatives, and is available to provide additional comments or information on this proposal if so requested. If you have any questions, please do not hesitate to contact me at (800) 486-2917 or jkozlowski@ohiocul.org.

Respectfully submitted,

John F. Kozlowski
General Counsel

Carole McCallister
Manager, Regulation & Information

cc: Mary Dunn, Credit Union National Association General Counsel
Barry Shaner, OCUL Chair
OCUL Board of Directors
Ohio Governmental Affairs Committee
Paul Mercer, OCUL President