BCU

July 29, 2013

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

Subject: Comments on Proposed Rule - Derivatives

Dear Ms. Rupp:

Once again, we appreciate the opportunity to comment on the Proposed Rule - Derivatives. As stated in our response to the previous ANPR on this topic, access to the tools that enable credit unions to effectively manage their balance sheets in a cost effective and capital sensitive manner is prudent and necessary. The proposed rule is a welcome step in recognizing this.

We concur that appropriate attention should be placed on education, experience and controls regarding the use of derivatives, no different than expectations we have for appropriate lending knowledge and processes, or even payment products and oversight. As such, derivatives have been an important and successful tool in helping financial institutions cost effectively manage risk on balance sheets for many decades.

Specifically, we have identified multiple areas where we believe the Proposed Rule - Derivatives can be improved.

1. Limits on notional amounts are inappropriate for effective hedging strategies. For example, $10 million of a 5-year swap represents a different level of risk than $10 million of a 1-year swap even though both have the same notional amount.

2. The maturity and average life restrictions are overly constraining for effective hedging strategies. Currently, our interest rate risk hedging strategies utilize Federal Home Loan Bank advances to provide longer liabilities that offset longer assets. Our internal policies allow us to borrow up to 10 years using fixed rate advances. In today's market, the interest expense for a 10-year swap is less than the interest expense for a 10-year advance, thereby making it an attractive hedge. Since many of the loans that we are trying to hedge are longer-term in nature, being limited to a maximum weighted average life of 5 years for derivatives (Level 1 authority) would result in a duration mismatch or require a larger notional amount of shorter derivatives to achieve the desired hedge coverage.

3. Limits on mark-to-market changes independent of the asset or liability being hedged are inappropriate and will negatively impact effective hedging strategies. If the amount of the loss for the derivative position is offset by a corresponding gain on the hedged item (or vice versa), this indicates an effective hedge. The loss on the derivative position should not be considered in isolation.

4. Risk management needs vary by institution and the required tools should reflect this. Interest rate floors should be allowed. Just as caps are useful for hedging rates-up risk, credit unions with interest rate risk exposure to rates-down scenarios need access to the proper types of derivatives.

5. Experience requirements should also consider the competency and capability given a capital markets background, and not solely derivative specific. We agree that third-party firms can be a source of external expertise, thus supplementing program needs.

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6. The application based fees will present a barrier to entry for some credit unions, discouraging them from pursuing effective hedging tools/strategies. This activity-specific cost sets an inappropriate precedent given fees are not assessed based on other credit union activities or products.

7. FISCUs should be allowed to use derivatives as long as they are not prohibited by the state. State level statutes are unlikely to specifically grant authority to use derivatives since their use has been precluded by the NCUA in the past. Other products and activities are allowed for FISCUs as long as they are not prohibited by the state. Also, an application must be made by the FISCU to the state in order to get derivatives authority, so the state has the opportunity to review the application for derivatives authority by the FISCU.

One remaining item is a question regarding the use of derivatives. In the example of a credit union using receive-fixed swaps in order to mitigate the interest rate risk associated with a decline in interest rates (such as a specific instrument like a fair value mortgage servicing rights or variable rate assets), would this strategy be allowed even if it increased overall balance sheet interest rate risk in rising rate scenarios (providing interest rate risk was within policy limits)?

Lastly, we want to reiterate our agreement that an appropriate framework must be in place at the regulatory and institutional level, however, we also encourage NCUA to reasonably approach a final solution in a manner that does not dilute the benefits to be derived by creating excessively burdensome and costly program requirements. To do so would minimize the good intention of providing access to tools to help credit unions manage risk.

Thank you for the opportunity to comment on this subject. Please feel free to contact us with questions or comments regarding this response.

Sincerely,

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Director of Balance Sheet Management

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