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VIA EMAIL ONLY AT: regcomments@ncua.gov

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

Re: Styskal, Wiese & Melchione, LLP Comments on Proposed Rule – Derivatives

Dear Ms. Rupp:

This letter is written on behalf of Styskal, Wiese & Melchione, L.L.P., a law firm located in Southern California which represents hundreds of credit unions, both state and federal. The firm began representing credit unions in all aspects of their operations on an almost exclusive basis in 1987.

We are writing to provide our comments on a limited portion of the Proposed Rule regarding Derivatives, specifically the requirement in § 703.108(b)(5) that credit unions obtain a formal legal opinion from qualified counsel prior to engaging in derivatives transactions (the "legal opinion requirement"). Other portions of the Proposed Rule have been or will be commented upon by other parties. However, we believe our input on the legal opinion requirement may be particularly useful to the NCUA.

We believe the legal opinion requirement is ambiguous and unnecessarily broad. As drafted, the language of §703.108(b)(5) leaves open a myriad of interpretations as to who would satisfy the definition of "qualified counsel," as well as to the scope of the required legal opinion. Additionally, we do not believe this requirement provides any added benefit to either the NCUA in its regulatory capacity or credit unions in their risk management and vendor management efforts. Instead, the requirement will add significant costs to the regulatory burden of credit unions (which regulatory burden also does not appear to have been calculated into the NCUA's Paperwork Reduction Act calculations).

As discussed below, we believe the legal opinion requirement should be eliminated, or the Proposed Rule should be altered to ensure that requirements for the ISDA agreement are clear, able to be interpreted in a consistent manner, and present the least regulatory burden that will still answer the NCUA's concerns regarding derivatives transactions.

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1. The Proposed Rule is Ambiguous and Overly Broad

Our concerns about the legal opinion requirement extend to multiple aspects of the requirement's language. We discuss each of our concerns in the paragraphs below.

a. The Required Scope of the Legal Opinion is Ambiguous

The Proposed Rule requires that a credit union obtain a legal opinion from qualified counsel stating that the "ISDA agreements" used "are enforceable and that the credit union is complying with applicable laws and regulations relating to operating a derivatives program."

First, the Proposed Rule's requirement that a credit union obtain a legal opinion stating that a credit union's ISDA agreements are "enforceable" is either unnecessary or unclearly defined. Enforceability could be interpreted in any number of ways. For example, counsel reviewing a derivatives agreement could determine that it is generally enforceable under contract law if there is an offer, acceptance, and consideration paid.[1] Alternatively, legal counsel might believe that the enforceability requirement necessitates that the agreement not be in violation of any of the restrictions contained in the Proposed Rule itself. Yet others may review the derivatives agreement to determine if the specific derivatives transactions to be performed under the agreement will be enforceable against their counterparties. The indistinct standard of "enforceability" leaves open the possibility of vastly inconsistent legal reviews and determinations of what is, or is not, an enforceable derivatives agreement. Such ambiguity will result in confusion among attorneys issuing such opinions, and increase the costs to credit unions in obtaining legal analysis in this area.

Second, the requirement that the legal opinion state that the credit union "is complying" with applicable laws and regulations relating to operating a derivatives program is ambiguous. Again, it is unclear what is required to satisfy this standard. It could mean that the credit union must be complying with the provisions of only the Proposed Rule; but it could also mean that any derivatives transactions to be entered into under the agreement must comply with applicable Securities and Exchange Commission ("SEC") rules. More importantly, as a credit union cannot begin transacting in derivatives until obtaining the legal opinion required by Section 703.108(b)(3), no laws or regulations relating to derivatives transactions would yet apply to a credit union at the time it seeks the opinion—a credit union would certainly be "in compliance" because it would not have yet executed a derivatives transaction.

[1] If this were the case, it seems likely that almost all credit union derivatives agreements would be found to be enforceable, essentially rendering the legal opinion requirement meaningless.

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Third, we note that this requirement seems to differ slightly from the Preamble to the Proposed Rule. The Preamble describes the requirement at a high level as requiring "a credit union to obtain a legal opinion . . . before executing any derivatives transaction." While the Proposed Rule itself discusses the ISDA agreement under which derivative transactions are executed, the preamble seems to suggest that the required legal review applies to specific transactions under the ISDA agreement.

b. The Required Qualifications for Legal Counsel are Ambiguous

While the scope of the required legal opinion is ambiguous, we believe the requirement for legal counsel's qualifications is more ambiguous. Under the Proposed Rule, qualified counsel is defined as an attorney with at least five years of experience "reviewing derivatives transactions." This requirement raises any number of questions as to what "reviewing derivatives transactions" entails, such that it would be extremely difficult to determine who a credit union should employ to conduct the legal review. Must an attorney review "derivatives transactions" full time for five consecutive years to qualify, or can the attorney have been involved in a variety of types of projects, including derivatives transaction review, during five years? Will five years of reviewing ISDA agreements qualify, or must the attorney have reviewed specific transactions that are made under an ISDA agreement? Is there a certain type of derivatives transaction that counsel must have been reviewing? Is there a specific aspect of a transaction which must have been reviewed, or will review of any portion of the derivatives transaction do?

Under the Proposed Rule as drafted, the most apparent plain meaning of the requirement is that the attorney must have been involved in reviewing specific transactions under an ISDA agreement (or similar agreement), and that activity must have been a primary use of the attorney's time for at least five years of nonconsecutive time. We believe the number of attorneys who will meet that requirement (particularly attorneys licensed in states without significant "Wall Street level" involvement) will be so minimal as to make compliance impracticable for a number of credit unions.

c. The Required Qualifications for Legal Counsel are Unnecessary for the Type of Opinion Requested

Even if the level of involvement with derivatives transactions an attorney must have is established, it is unclear why legal counsel must have this extent of experience reviewing derivative transactions to produce the product being requested. Indeed, if the requirement is that counsel's opinion establishes that an agreement is enforceable (in the most basic contract law sense), then most any first year attorney would be able to competently perform such a review. An opinion of counsel to establish that the ISDA agreement allows only for derivatives transactions which comply with the NCUA's rules and SEC

rules to be performed may require additional experience; however, such experience need not be with the review of transactions under an ISDA agreement.

Instead, the qualifications requested suggest that the credit unions involved (a) will have bargaining leverage over the type of derivatives being offered and their underlying terms;[2] and/or (b) will be obtaining advice regarding compliance matters and prudential risk-related matters that are not in the ISDA agreement;[3] and/or (c) will be engaging the attorney to negotiate revisions to the standard ISDA agreement which will involve significant departures from normal over the counter transaction practices.[4] Accordingly, the misalignment of the required experience to the required opinion further complicates compliance for, increases costs on, and burdens credit unions.

2. The Proposed Rule is Unnecessary to Meet the NCUA's Stated Goals

We also have concerns about the concept behind a legal opinion as a requirement of the regulation. We understand the NCUA's motivations in creating the legal review requirement—it may help ensure that agreements under which derivatives transactions are performed are not out of the ordinary, and may help prevent derivatives transactions that fall outside of the restrictions of the Proposed Rule. Indeed, the NCUA has indicated that its previous prohibition against credit unions engaging in derivatives transactions stemmed, in part, from the potential degree of risk associated with the complexity of derivatives as financial instruments, and that that outside legal review is necessary to ensure "a higher degree of sophistication [and] analytical rigor." However, it is unclear how the legal review requirements in Section 703.108(b)(5) of the Proposed Rule address these concerns.

The majority of derivatives agreements are non-negotiable because a standard form, created by the ISDA, is utilized. The ISDA agreement itself is, in practice, not modified, but rather amendments of certain provisions can be entered into the ISDA agreement as appendices (though in practice those amendments are rarely contemplated for institutions of the size of all but a handful of credit unions). The form ISDA agreement is regularly subject to legal review, and the ISDA itself obtains legal opinions about the enforceability of its agreements.[5] Accordingly, unless an element of the negotiated appendices eliminates consideration for the agreement or makes the agreement illegal for the particular parties, there would appear to be minimal risk that the agreement is unenforceable. Thus, an opinion regarding enforceability will be of limited use—a legal opinion obtained by the credit union regarding enforceability

[2] A situation that will not even be possible, as such credit unions will still be restricted to "plain vanilla" derivatives.
[3] Which advice would not be contained in a formal legal opinion in normal practice.
[4] Which negotiation would not involve issuance of a formal legal opinion in normal practice.
[5] http://www2.isda.org/functional-areas/legal-and-documentation/opinions/

will not provide whether the agreement as negotiated is prudent, or whether specific provisions will be interpreted favorably to the credit union.[6]

A legal opinion regarding compliance before any derivatives transactions are instituted will also be of limited use to answer the NCUA's concerns. As noted above, logic would dictate that before engaging in transactions all credit unions will be in compliance with regulatory requirements that relate to derivatives. Assessments to absorb losses, processes to limit loss exposure, due diligence on counterparties, vigilant collateral management, reliance on third parties, and lack of analysis of transaction costs are all answered through internal reviews and program establishment, not through a legal opinion. Compliance with the NCUA's investment rules will be a fluid determination; therefore, a static moment's determination of compliance at the beginning of a program or relationship is unlikely to be useful.

Instead, limitations on counterparties (i.e., the limited number of permissible swap dealers and swap participants available), institution of audit requirements, and requirements for internal management qualifications answer the NCUA's concerns. Indeed, aside from establishing compliance with § 703.108(b)(5), we see no apparent benefit to credit unions to expending resources on a legal opinion. Accordingly, we believe the requirement to seek outside legal review is not only duplicative in purpose, but would create an additional unnecessary financial burden for credit unions.

3. The Legal Opinion Requirement is not Included in the Paperwork Reduction Act Calculation

Section 703.108(b)(5)'s requirements do not appear to be included as a cost for the purposes of complying with the rule. Interfacing with attorneys and paying for an opinion letter will take a significant amount of management's time, and depending on the scope of the requested opinion and the rarity of attorneys with the required qualifications, may involve significant costs (tens of thousands of dollars).

4. Alternatives are Available which Align with the NCUA's Goals and Decrease Burdens on Credit Unions

We acknowledge that the NCUA may not be willing to entirely eliminate regulation of the legal form of the agreements under which derivatives transactions occur. Accordingly, if the NCUA will not eliminate the legal opinion requirement, we believe the NCUA should replace it with an alternative which will pose a lesser burden to credit unions—the NCUA's goals can be furthered without the cost and burden of an ambiguous requirement to obtain a legal opinion.

[6] Neither of which would be plausible to require in a regulation, or plausible for a credit union to obtain a meaningful opinion about.

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Instead, the NCUA can satisfy its concerns about the general nature of the agreement through monitoring and enforcement under other provisions in the Proposed Rule. We agree that maintaining certain standards and guidelines for internal credit union management and personnel expertise in the area of derivatives is essential to the NCUA's goals of risk mitigation. Internal management like that suggested in § 703.108(a)(3)[7] and internal control audits as required by § 703.108(b)(3) (including review of legal controls) answer the NCUA's concern more thoroughly, and infuse more sophistication and oversight into a credit union's derivatives program.

As another alternative, the NCUA could require that credit unions use a standard derivatives agreement of a form similar to the one currently issued by ISDA. Such a step should ensure that the agreement is enforceable. The NCUA could also require that the parties add provisions requiring each transaction thereunder to comply with Part 703 and the Federal Credit Union Act. Such a change would be minimal, and would contractually require compliance without the unnecessary cost of an attorney opinion. This clearly articulated standard would also reduce discrepancies between what different "qualified counsel" determine to be enforceable (depending on what they interpret "enforceable" to mean) in different situations, while at the same time providing ease of regulatory oversight.

Regardless of the chosen alternative, any such alternative should balance risk management benefits with regulatory burden and cost, and provide greater clarity to this requirement.

We hope these comments are helpful to the NCUA as it continues to consider the use of derivatives by credit unions, and the requirements for credit unions which do engage in derivatives transactions. If we can be of further assistance in the NCUA's consideration of this Proposed Rule, we would be pleased to offer our thoughts.

Sincerely,

STYSKAL, WIESE & MELCHIONE, LLP

Timothy I. Oppelt

TIO/pc

[7] Requiring "qualified derivatives personnel" having direct experience in transacting in derivatives to be employed by credit unions participating in derivatives.