The Wisconsin Credit Union League

One League, One Focus - Your Success!

Via email: regcomments@ncua.gov

July 29, 2013

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

Re: Comment on Proposed Amendments to Rules 703, 715, and 741: Derivatives Investment Authority

Dear Ms. Rupp:

The Wisconsin Credit Union League, serving 178 credit unions and 2.4 million members, welcomes the opportunity to provide the following comments regarding the NCUA's proposed rule permitting approved credit unions to invest in some derivatives (interest rate swaps and caps) as a hedge against interest rate risk. We appreciate the agency's introduction of this tool that can minimize risk to credit unions (when, for example, fixed-rate mortgage loan rates are rising) as well as to the NCUSIF.

On behalf of our member credit unions, we support NCUA's intent to authorize derivative investments for credit unions and urge that credit unions also be permitted to use derivatives to enhance the financial return to the credit union, not simply to mitigate interest rate risk. As to the current proposed rule, we offer the following comments:

Eligibility to Apply for Authority to Invest in Derivatives. We oppose the provision in the proposed rule that requires a credit union to have at least $250 million in assets before it can apply for derivatives authority. Setting an asset level minimum threshold for the authority is arbitrary, as it is ability to meet the other requirements of the rule that should determine whether a credit union can or will apply and whether its application is approved. Credit unions of any size may have interest rate risk, and the purpose of this proposed rule is to provide an important tool for hedging that risk. A credit union of any size that can meet the other requirements of the rule should be permitted to apply for derivatives authority.

Application and Supervision Fees. For two reasons, we strongly oppose the onerous application and supervision fees proposed in the rule. First, imposing these fees would set an unfortunate precedent. What is the next activity or investment strategy for which the agency would decide to "charge extra"? Credit unions have already been paying extra, at a very challenging time for them, for the corporate failures—where the NCUA has front-loaded assessments rather than spreading them out over the years it could have. It's important to note also that an extra charge for application and supervision fees does not similarly impact credit unions of different sizes. A precedent of charging extra for this investment opportunity or any other activity would, for

N25 W23131 Paul Road Pewaukee, Wisconsin 53072-5779
Phone: (262) 549-0200 or (800) 242-0833 Fax: (262) 549-7722 Web: www.theleague.coop
Member Credit Union National Association

the most part, favor larger credit unions over smaller ones that engage in any investment, new service or product, or other opportunity even though it has been authorized by the NCUA for all of them.

The point of this proposed derivatives rule is to provide a vehicle with which a credit union can minimize its interest rate risk. That's a good thing—for a participating credit union and the insurance fund. Credit unions that otherwise meet the requirements for using the strategy should be encouraged to do so—not discouraged by high fees or supervisory costs. Investing in derivatives is intended to prevent poor income results, not increase profits. So the impact of application and supervision fees is, in effect, to charge credit unions to better manage their risk. If any application fee is charged, it should be much less.

Expertise and Experience Requirements. We understand and support the general requirement that credit unions engaging in derivative investments use qualified, experienced personnel to do so. However, requiring personnel at a credit union applying for derivative investment authority to have at least three years of direct transaction experience with financial derivatives *at a financial institution* is too onerous—especially considering that credit unions (except for those in the pilot program) have so far been prohibited from dealing in derivatives. We therefore urge that the proposed regulation be amended to allow credit unions to retain the necessary experience and expertise through a qualified external service provider. Credit unions have experience with this, as they typically rely on external service providers for services that might otherwise be cost prohibitive.

One aspect of the proposed rule related to this topic that we do not understand is that it would permit a wholly-owned CUSO—but not a CUSO owned by more than one credit union—to perform derivative transactions. If a CUSO has personnel with the expertise and experience required by the rule, what difference does it make if the CUSO is wholly-owned or not? The rule as proposed would only assure higher costs for credit unions and therefore make it less likely they can afford to use this risk-reduction tool. We urge the agency to change this part of the proposed rule to permit credit unions to use a CUSO that otherwise meets the rule's experience and expertise qualifications to provide derivative investment services to credit unions.

Auditing and Legal Review Requirements. We ask that the NCUA reconsider the requirements that all applying and participating credit unions have an internal controls audit in place and use an attorney with at least five years of experience reviewing derivatives transactions. Both of these requirements reach too far and will add yet further cost for credit unions wishing to use derivatives to mitigate interest rate risk. Appropriate audits with reasonable assurances that adequate internal controls are in place are certainly necessary. The credit union's financial statement audit would require these assurances in any case. And certainly credit unions should hire attorneys with the proper skills and experience necessary to perform a derivatives review. But the level of derivatives transactions being authorized for credit unions under this proposed rule do not warrant the restrictive, expensive legal review requirements described in the current proposal. We urge the agency to pare back the auditing and legal review requirements in the proposed rule so that they are in line with the safety and soundness realities of the transactions that will be permitted.

Reporting. Likewise, we request that the proposed rule be changed to permit participating credit unions to outsource reporting requirements to competent third parties. Requiring a credit union to maintain the infrastructure and personnel to do the reporting itself will be expensive and may very well cause a credit union that is planning only a small number of derivatives transactions or with limited derivatives exposure not to do them at all. Again, the point of permitting derivatives investment is for credit unions to hedge against interest rate risk and to save the NCUSIF money. Making it too expensive for credit unions to participate undermines significantly the potential of this mitigation.

Requiring a credit union to provide a full net economic value to its board every month is an onerous burden and another deterrent to a credit union's participation in this interest rate risk-reducing option. A better requirement might be to provide such a report to the board quarterly, or, if monthly reporting will remain in the rule, to provide a valuation of the derivatives and hedged items instead of a report of full net economic value. This latter option might actually give a clearer understanding of a derivative to a board, which in turn translates to better oversight.

Investment Levels, Collateral, and Duration.

We urge the agency to include in the final rule a waiver process or higher level of authority for credit unions that can demonstrate their need and ability to manage more complex derivatives. For credit unions with the expertise to do so, limiting too much the use of this tool to manage their interest rate risk would be counterproductive of the rule's intent.

We suggest that participating credit unions be allowed to use agency mortgage-backed securities and pass-through certificates, which are fully guaranteed as to both principal and interest by the Federal Home Loan Bank, Fannie Mae, Ginny Mae, or the Federal Home Loan Mortgage Corporation. Limiting collateral for derivative investments to cash, treasury securities, and agency debentures is too restrictive.

As the purpose of this rule is to provide a tool for hedging against interest rate risk, the duration limits should be increased to give credit unions more flexibility in matching derivative investments to risks. For different situations, the appropriate duration of an investment might be different, but that argues for more durational flexibility rather than less.

In conclusion, we applaud and support the NCUA's efforts to authorize credit unions to invest in derivatives. We believe, however, that the rule as proposed is too restrictive and that several of the costly and burdensome requirements are unnecessary and will preclude many credit unions from using this valuable investment tool, saving dollars for credit unions and the NCUSIF. We urge the NCUA to revise the proposed rule to promote investment in derivatives rather than discourage their use. Moreover, we encourage the NCUA to consider permitting qualifying credit unions to use these investments to enhance their overall financial returns, not just mitigate risk.

Thank you.

Sincerely,

Joanne R. Whiting
EVP and Chief Advocacy Officer
The Wisconsin Credit Union League