July 29, 2013

Mary Rupp, Secretary of the Board
National Credit Union Administration
1775 Duke St.
Alexandria, VA 22314–3428

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

Dear Ms. Rupp:

On behalf of the Credit Union Association of New York, I would like to take this opportunity to comment on NCUA's proposal to allow credit unions with $250 million in assets to utilize derivatives as a hedge against interest rate risk. The Association is supportive of any proposal that gives credit unions greater ability to guard against interest rate fluctuations. In addition, New York credit unions recognize that the use of derivatives requires a level of expertise and infrastructure beyond the needs of many credit unions.

However, this regulation as proposed is so restrictive that it would disqualify credit unions that are ready, willing and able to invest in derivatives. Consequently, the regulation ultimately promulgated by NCUA should increase both the pool of credit unions eligible to seek derivative investment powers and the flexibility of qualified credit unions to use derivatives in a cost-effective manner.

Not only is NCUA sharply limiting the potential pool of qualified credit unions and imposing comprehensive oversight on eligible credit unions; it is limiting credit unions to two "plain vanilla" products: interest rate swaps and interest rate caps. Given the level of due diligence that NCUA is planning to undertake before giving a credit union derivatives authority, combined with unprecedented staffing requirements and documentation to be required of credit unions authorized to hedge with derivatives, NCUA should expand the number of derivatives in which authorized credit unions are eligible to invest. Just as "cap" derivatives could help credit unions guard against interest rate increases, "floors" could insure that credit unions could guard against sudden interest rate drops. In many respects, these derivatives are the mirror images of caps. It makes little sense to view one as inherently riskier than the other. As the industry's experience with quantitative easing has demonstrated, such sudden drops can harm credit unions almost as much as unexpected rate increases.

In addition to expanding the list of authorized derivatives, NCUA should amend the regulations so individual credit unions can purchase derivatives not specifically authorized in the regulation. Credit unions seeking such ad hoc authority would have to demonstrate: (1) why the existing derivatives authority does not address their unique circumstances, and (2) how the derivative they seek to use would be an effective hedge given their financial profile.

A second aspect of the proposal that should be modified is the $250 million asset threshold below which credit unions cannot apply for expanded derivative powers. Our member credit unions have expressed strong opinions

that most credit unions would not seek derivatives authority—and that most that *would* seek to hedge with derivatives would apply only after an assessment that they need such flexibility. NCUA should be concerned not with a given credit union's asset size, but with whether it has the need and expertise to utilize derivatives properly. There is no reason to assume that a $245 million credit union has no need to incorporate derivatives into their hedging strategy. No similar limit is placed on community banks.

We also believe that some of the proposed oversight requirements imposed on qualified credit unions go beyond heightened safety and soundness concerns and amount to counterproductive micro-managing. For instance, prior to every purchase, a credit union would have to document the circumstances leading to its decision and specify the strategy to be used in the transaction. It's perfectly appropriate for NCUA to mandate that credit union personnel have derivatives expertise; it's quite another to have that personnel document the thought processes on investments that haven't even occurred and are dealing with inherently fluid economic conditions.

Finally, NCUA is proposing to make applicants pay between $75,000 and $125,000 as a way of offsetting the costs of derivative regulation. Under no circumstances should regulatory flexibility be based on a pay to play model, where only bigger credit unions that can absorb the costs are given expanded powers while other credit unions are denied the benefit of regulations because the upfront costs of compliance are too prohibitive. The sole question for NCUA should be whether a credit union has a demonstrable need for and expertise to utilize derivatives. The Association views this aspect of the proposal as a dangerous precedent that should not be adopted no matter what form the final regulations take.

For several years now, NCUA has joined other banking regulators in warning against the interest rate risks posed by historically low interest rates. This proposal is a limited but important step in recognizing that credit unions need more flexibility to hedge against the risks posed by sudden shifts. The final regulation must be structured so that all qualified credit unions can cost-effectively utilize the derivatives that best hedge against unseen risks. Under the current proposal, the regulatory burden of compliance would outweigh the benefits of derivative hedging for all but a handful of credit unions. This would be an unfortunate outcome.

Accordingly, I urge you to amend the proposed regulations to give qualified credit unions the flexibility they need and deserve to manage risk and choose derivatives.

Sincerely,

William Mellin
President/CEO
Credit Union Association of New York