BOARD ACTION MEMORANDUM

TO: NCUA Board

DATE: January 14, 2014

FROM: Office of General Counsel
Office of Examination and Insurance

SUBJ: Subpart B to Part 703 - Derivatives

ACTION REQUESTED: Board approval to issue the attached final rulemaking for Part 703 subpart B for Derivatives in the Federal Register, with an effective date 30 days from the date of publication in the Federal Register.

DATE ACTION REQUESTED: January 23, 2014.

OTHER OFFICES CONSULTED: Regional Offices, ONES, and OCE.

VIEWS OF OTHER OFFICES CONSULTED: Concur.

BUDGET IMPACT, IF ANY: The proposed rule includes a requirement that a federal credit union seeking derivatives authority must submit a detailed application to the appropriate field director.

NCUA's review of derivative applications will necessitate an increase in its resources. These increases are primarily due to the incremental staff time involved in assessing a federal credit union applicant's program and its state of readiness to conduct derivative transactions. The extent of these resource needs depends on the amount and timing of applications:

- **Total number of potential federal credit union applicants.** The final rule limits eligible federal credit unions to those with assets of $250 million or more[1] – as of September 30, 2013 there were 393 federal credit unions that exceeded this asset threshold.
- **Estimated rate of application inflow.** Staff expects a significant application inflow during the first several years after the implementation of a final rule. A higher than expected inflow may require NCUA to contract external resources to augment its specialized staff.

Based on observed NCUA derivatives pilot program usage in the past and a review of contemporaneous bank Call Report data for derivatives positions, staff projects a range of 30 to

[1] The final rule provides NCUA field directors with the authority to permit a federal credit union that has assets under $250 million to apply for derivatives authority.

60 eligible federal credit unions may apply for derivatives authority within several years of adopting the final rule.

The two year resource projections below are based on the assumptions that most federal credit unions will apply for derivatives authority within the first two years the rule goes into effect and the rate of incoming applications will slow over time. Staff adopted these assumptions because they are more conservative from a contingency planning standpoint and better ensure NCUA has the capacity to process an influx of multiple applications in a timely fashion. Should the application demands exceed the capacity of current staff, staff is proposing the Board approve the engagement of temporary external resources to assist NCUA personnel as necessary.

Resource Projections

Staff estimates the following contingency costs for 2014 and 2015:

2014 - $.75 million for consulting
2015 - $.75 million for consulting

Generally, the supervision of credit union derivative programs will be an insurance-related cost and staff respectively recommends that such program costs be allocated to the NCUSIF.

While the agency does currently have specialized staff which can evaluate derivative applications and conduct ongoing supervision of derivative activities, it may need to contract the services of additional specialists should the level of applications exceed our internal capacity. The use of external consultants can have the added benefit of allowing NCUA to gain experience with state-of-the-art analytical platforms and evaluate the potential efficacy of such platforms for internal use. While the contingency consulting costs are forecasted to be the same over the first two years, these estimates can be refined in subsequent budget cycles as actual experience warrants.

Estimates for the cost of supervising derivative authority are lower in this proposal than they were for the Notice of Proposed Rulemaking issued by the Board in May 2013. This is largely due to the subsequent reallocation of six FTEs for additional internal specialized staff members who are qualified to assess derivatives and other complex asset/liability management risks and the final rule only applying to federal credit unions.

SUBMITTED TO INSPECTOR GENERAL FOR REVIEW: Yes.

RESPONSIBLE STAFF MEMBERS: Larry Fazio, Director, Office of Examination and Insurance; J. Owen Cole, Director of the Division of Capital and Credit Markets, Office of Examination and Insurance; Tom Fay, Senior Capital Markets Specialist, Office of Examination and Insurance; Justin M. Anderson, Staff Attorney, Office of General Counsel

SUMMARY: This final rule permits federal credit unions to engage in limited derivatives activities for the purpose of mitigating interest rate risk. The final rule addresses permissible derivatives and characteristics, limits on derivatives, operational requirements, counterparty and

margining requirements, and the procedures a federal credit union must follow to apply for derivatives authority.

RECOMMENDED ACTION: The NCUA Board approve the attached Final Rule, with an effective date that is 30 days from the date of publication in the Federal Register, and authorize up to $.75 million in contingency funds for consulting.

ATTACHMENT: Final Rule.