

# Derivatives Authority Qualitative Review Checklist

Federal Credit Union Information																
Credit union name																
Charter number																
Assets <sup>1</sup> (enter whole dollar number from the most recent quarterly call report)	\$				,	2	5	0	,	0	0	0	,	0	0	0
CAMEL code (composite) (check the number from most recent exam)	<input type="checkbox"/> 1				<input type="checkbox"/> 2				<input type="checkbox"/> 3							
CAMEL code (management) (check the number from most recent exam)	<input type="checkbox"/> 1				<input type="checkbox"/> 2				-N/A-							
Contact Information																
Contact name																
Title																
Email / Phone																
<b>Requested Approval</b>	Interim Approval <input type="checkbox"/>							Final Approval <input type="checkbox"/>								
<i>Indicate each product / characteristic the credit union has requested approval to use with a checkmark</i>																
Interest rate swaps								<input type="checkbox"/>								
Basis swaps								<input type="checkbox"/>								
Interest rate caps								<input type="checkbox"/>								
Interest rate floors								<input type="checkbox"/>								
U.S. Treasury note futures								<input type="checkbox"/>								
Amortizing notional								<input type="checkbox"/>								
Forward start swaps								<input type="checkbox"/>								
NCUA USE ONLY																
Date application received										REGION/ONES						
Review completed by (name)																
Credit union eligibility (check one)	<input type="checkbox"/> Eligible (standard)				<input type="checkbox"/> Eligible (FD approved) <sup>2</sup>				<input type="checkbox"/> Ineligible							
Limits (check one)	<input type="checkbox"/> Entry limits							<input type="checkbox"/> Standard limits								

<sup>1</sup> If credit union has less than \$250 million in assets, it must submit documentation supporting the Field Director's approval as part of its application for derivatives authority.

# Derivatives Authority Qualitative Review Checklist

*After the field office determines if an application is complete and evaluated the safety and soundness of the credit union, the application will be reviewed by a panel from a qualitative perspective. Each member of the panel must complete their respective comment boxes to provide support for the overall assessment of the application.*

<b>Derivatives Application Qualitative Review (Interim Approval)</b>			
As part of the initial application process, after regions have determined completeness of the package submitted, a secondary review is to be done from a qualitative perspective. All members of the panel (Field staff, Field CMS, and SCMS) will complete their respective comment boxes to provide support for their overall assessment.			
<b>Interim Application Review</b>			
	<b>Field Staff Comments</b>	<b>Field CMS Comments</b>	<b>SCMS Comments</b>
<b>Safety and Soundness (Field Staff Only)</b> A credit union that plans to engage in derivatives activity is expected to be operated in a safe and sound manner. A preliminary review of the credit union's examination and supervision history and an evaluation of the status of any outstanding material supervisory concerns are essential to determining whether a credit union should be granted derivatives authority.			
#			
1	Does the credit union's asset size and CAMEL code meet the minimum qualifications to apply for derivative authority?		
2	Review current FPR and discuss the strength of the current financial condition and trends.		
3	Review most recent examination and/or supervision contact reports; discuss current CAMEL code, risk ratings and any outstanding material DOR or examiners findings.		
4	Review most recent Quality Control Review, Supervisory Evaluation Form and RATE review. Discuss any material issues identified in these reviews.		

# Derivatives Authority

## Qualitative Review Checklist

<b>Derivative Transaction and Limit Compliance</b> Understanding what products and hedging strategies to be implemented by the credit union is a critical part of the application. The credit union must demonstrate what products and characteristics are being used in the application. Product descriptions should be clear and referenced to the permissible derivatives subsection of the rule 703.102. The application should articulate what the hedging strategy will be in mitigating interest rate risks and how they will measure and monitor the positions against the prescribed limits.			
5	<b>Products (§703.102)</b> Application indicates what products the credit union plans on using and what the hedging objectives are. This should include what balance sheet characteristics are contributing to the interest rate risk, and how derivatives will reduce this risk.		
6	<b>Transaction Characteristics (§703.102)</b> If applicable, application indicates if credit union will use notational amortization or forward start date features, and what the credit union's hedging objectives are.		
7	<b>Limits Authority (§703.103)</b> Credit union recognizes the risk limits associated with the program and indicates how it will comply with them. This is required whether credit union applies with or without prior derivatives experience.		
<b>External Service Providers (including trade counterparties)</b> External Service Providers (ESPs), including transaction counterparties, are a critical component of operating a derivatives program. For transactions; the execution of transactions, the servicing of margin calls, the custodial duties of managing collateral, and in most cases providing current valuations of the transactions. For <i>operational support functions</i> , ESPs are a source of generic ALM functions used at many credit unions. For <i>transactions</i> , the type of agreement needed will vary based on the products the credit union has applied for and whether the credit union will use exchanges or use bilateral agreements will determine. For each product, the application should indicate the credit union's approach is and how it plans on supporting the agreement. For <i>support functions</i> , the application should be clear on what functions will be supported by an ESP, how each function will integrate back into the credit unions' operations, and how the credit union will control this process.			
8	<b>Trade Counterparties (§703.104)</b> Application includes a list of counterparties the credit union plans on using and indicates whether transactions will be cleared, non-cleared, or exchange cleared.		

## Derivatives Authority Qualitative Review Checklist

9	<i>Collateral and Margining (§703.104)</i> Application indicates how credit union will support the collateral and margining requirements detailed in the rule.			
10	<i>Support Functions (§703.107)</i> Application indicates which ESP(s) credit union will use to support derivatives, what functions the ESP(s) will perform, and how supported functions will be integrated into the credit union's operations.			
11	<i>Support Functions (§703.107)</i> Credit union must demonstrate how it will support the ALM and liquidity management functions internally and independently.			
12	<i>Legal Documents (§703.106)</i> Depending on the approach to ESPs, credit union has indicated what contractual agreements it plans on executing.			
<b>Management Reporting</b> Ensuring that a credit union's business plan supports its interest rate risk mitigation plans is a critical part of ALM. Similar to the topics above, the credit union's understanding of the hedging strategy as part of its overall balance sheet management should be documented. For internal management reporting, the credit union should have the relevant reporting to indicate the current risks, positions and hedge effectiveness.				
13	<i>Risk Mitigation Plan (§703.110)</i> Application includes plan on how credit union will monitor interest rate risk using derivatives, and analysis of using other balance sheet options, and how new instruments will be incorporated into existing risk reporting.			
14	<i>Risk Mitigation Plan (§703.110)</i> Credit union indicates what analytical modeling it has done to understand the risk sensitivity of the proposed derivative positions and how effective the hedge will be.			
15	<i>Internal Reporting (§703.105)</i> Application describes how the credit union will modify or develop internal reporting to include derivatives, and report to the Board and senior executive officers as required by the rule.			

# Derivatives Authority

## Qualitative Review Checklist

<b>Operational Requirements</b> How a credit union supports and monitors the oversight of a hedging program is critical to its success. The governance and management of ALM activities, including derivatives, requires a greater level of sophistication. In this section, assess how management is conducting activities to support a hedging program and how the internal control framework is supporting those activities. Proper separation of duties, a robust internal control framework and the compliance with GAAP for accounting results are the core attributes for this section.			
16	<i>Board Resolution (§703.106)</i> Application includes a resolution from the credit union board of directors or approval in board minutes.		
17	<i>Senior Executive Officer Oversight (§703.106)</i> Application describes how the executive officers will oversee the safety and soundness of the derivatives program.		
18	<i>ALM Oversight (§703.106)</i> Application details what procedures or plans the credit union will develop or amend on how it will conduct risk oversight of derivatives and integrate derivatives into the overall ALM framework.		
19	<i>Accounting (§703.106)</i> Credit union indicates what accounting designation it plans on using and how it will comply with GAAP, as part of the execution strategy.		
20	<i>Financial Statement Audit (§703.106)</i> Application acknowledges that the credit union is planning to contract with an independent auditor for a year-end financial statement audit.		
21	<i>Internal Controls (§703.106)</i> Application acknowledges that an independent (external or internal) review of derivative internal controls for the first two years of the program.		
22	<i>Process Framework (§703.106)</i> Application indicates that a documented plan on the process flow will be produced for the final review; the plan should include roles and responsibilities for each of the major functions in supporting derivatives.		

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23	<i>Separation of Duties (§703.106)</i> Process framework indicates how the credit union will comply with the required separation of duties.			
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Application Assessment Conclusion and Recommendation (Interim Approval)				
24	Are the application content and business plans sufficient enough to make an assessment?			
25	What part(s) of the application would need more information if the credit union pursues final" derivatives authority?			
26	Given the information that has been presented to me, and in consultation with the other panel member and field office staff, I recommend to <b>approve/decline</b> this application.			
27	<b>Joint panel recommendation for interim authority (approve or decline)</b>			

Derivatives Application Qualitative Review (Final Approval)				
<p>As part of the initial application process, after regions have determined completeness of the package submitted, a secondary review is to be done from a qualitative perspective. All members of the panel (Field staff, Field CMS, and SCMS) will complete their respective comment boxes to provide support for their overall assessment.</p>				
Final Application Review				
	Field Staff Comments	Field CMS Comments	SCMS Comments	
<b>Safety and Soundness (Field Staff Only)</b> A credit union that plans to engage in derivatives activity is expected to be operated in a safe and sound manner. A preliminary review of the credit union's examination and supervision history and an evaluation of the status of any outstanding material supervisory concerns are essential to determining whether a credit union should be granted derivatives authority.				
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1	Does the credit union's asset size and CAMEL code still meet the minimum qualifications to apply for derivative authority?			
2	If a new call report cycle has closed since the interim approval, review the FPR. Discuss any changes to financial condition or trends since interim approval, if applicable.			

## Derivatives Authority Qualitative Review Checklist

3	If a supervision or examination report has been uploaded since the interim review, evaluate if any changes were identified or material issues have emerged, if applicable.			
4	If a new Quality Control Review, Supervisory Evaluation Form, or RATE has been approved since the interim approval, review and comment on any material issues, if applicable.			
<b>Derivative Transaction and Limit Compliance</b> Understanding what products and hedging strategies to be implemented by the credit union is a critical part of the application. The credit union must demonstrate what products and characteristics are being used in the application. Product descriptions should be clear and referenced to the permissible derivatives subsection of the rule 703.102. The application should articulate what the hedging strategy will be in mitigating interest rate risks and how they will measure and monitor the positions against the prescribed limits. <b>For the final review assessment, the credit union must include a document of policies and procedures to support the limits monitoring.</b>				
5	<i>Products (§703.102)</i> If following up on an interim approval, product strategy is consistent and use strategy is very clear on how credit union will use products.			
6	<i>Products (§703.102)</i> Application demonstrates the benefit and goal of using each product and what interest rate hedging objectives are being met.			
7	<i>Transaction Characteristics (§703.102)</i> Requests for product characteristics are consistent with application for interim approval, if applicable.			
8	<i>Transaction Characteristics (§703.102)</i> Application demonstrates the benefit and goal of using each characteristic and what interest rate hedging objectives are being met.			
9	<i>Limits Authority (§703.103)</i> Credit union acknowledges the rule limits, the calculations as per the rule, and identifies what processes and reporting have been developed to monitor the limits.			
10	<i>Limits Authority (§703.103)</i> Credit union has provided report prototypes that demonstrate how it will monitor limits.			

# Derivatives Authority

## Qualitative Review Checklist

11	<i>Limits Authority (§703.103)</i> Credit union has provided procedures which will ensure that valuations and positions are reconciled with the counterpart, and that the fair value limit is consistent with this.		
12	<i>Limits Authority (§703.103)</i> Determine whether program qualifies for <i>entry</i> or <i>standard</i> limits using the rule requirements.		
<b>External Service Providers (including trade counterparties)</b> External Service Providers (ESPs), including transaction counterparties, are a critical component of operating a derivatives program. For transactions; the execution of transactions, the servicing of margin calls, the custodial duties of managing collateral, and in most cases providing current valuations of the transactions. For <i>operational support functions</i> , ESPs are a source of generic ALM functions used at many credit unions. For <i>transactions</i> , the type of agreement needed will vary based on the products the credit union has applied for and whether the credit union will use exchanges or use bilateral agreements will determine. For each product, the application should indicate the credit union's approach is and how it plans on supporting the agreement. For <i>support functions</i> , the application should be clear on what functions will be supported by an ESP, how each function will integrate back into the credit unions' operations, and how the credit union will control this process. <b>Policies and procedures must be included for the final review assessment.</b>			
13	<i>Trade Counterparties (§703.104)</i> Application details what counterparties the credit union will use to execute transactions.		
14	<i>Trade Counterparties (§703.104)</i> Application details what swap dealer, futures commission merchants (FCM), or introducing brokers have been contracted and whether they are clearing or using a bilateral agreement. Contract discloses that only certain contracts can be done, consistent with the application of products.		
15	<i>Collateral and Margining (§703.104)</i> Assess the qualifications of the staff that will be supporting this function.		
16	<i>Collateral and Margining (§703.104)</i> Guidelines in the counterparty agreement(s) detail the eligible collateral and margining requirements are compliant with the rule.		
17	<i>Collateral and Margining (§703.104)</i> Evidence that the credit union has the systems, procedures and trigger notifications to support margin calls.		



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18	<i>Collateral and Margining (§703.104)</i> Review the reporting that shows the counterparty risk and how the credit union is compliant with the minimum transfer or FCM margin requirements.			
19	<i>Support Functions (§703.107)</i> Review documents on what ESP(s) the credit union is using to support or integrate derivatives, and in what capacity they are being used.			
20	<i>Support Functions (§703.107)</i> Application contains reports that will be used for risk, position, and fair value gain (loss).			
21	<i>Support Functions (§703.107)</i> Confirm that service providers for support functions are not derivative counterparties (which is not allowed by the rule).			
22	<i>Support Functions (§703.107)</i> Credit union has demonstrated that it is capable of overseeing and managing an ESP, and has the resources to do so, where the ESP is providing interest rate risk measurement models and/or liquidity measurement and support functions.			
23	<i>Support Functions (§703.107)</i> Credit union has documented how it is controlling the data and process flow integration points using a service provider.			
24	<i>Legal Documents (§703.106)</i> Credit union has provided signed agreements with all service providers to execute transactions, support margining, and all other operational support.			
<b>Management Reporting</b> Ensuring that a credit union's business plan supports its interest rate risk mitigation plans is a critical part of ALM. Similar to the topics above, the credit union's understanding of the hedging strategy as part of its overall balance sheet management should be documented. For internal management reporting, the credit union should have the relevant reporting to indicate the current risks, positions and hedge effectiveness. <b>Policies and procedures must be included for final review assessment.</b>				

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25	<i>Risk Mitigation Plan (§703.110)</i> Credit union has provided a detailed plan on the hedging objectives using derivatives, how other interest rate options were considered, and what the economic benefits will be and how the program is reducing or has the potential to reduce interest rate risk.			
26	<i>Risk Mitigation Plan (§703.110)</i> Credit union's risk mitigation plan considers how derivatives can be an alternative to other interest rate mitigation strategies; credit union demonstrates that it has done a cost/benefit analysis.			
27	<i>Risk Mitigation Plan (§703.110)</i> Credit union outlines what analytical modeling was done to understand the risk sensitivity of the derivative positions and how effective the hedge will be. Check for improvements or changes to the material provided for interim review, if applicable.			
28	<i>Risk Mitigation Plan (§703.110)</i> Credit union uses the forward interest rate curve to estimate its cost of funds over the next five years.			
29	<i>Risk Mitigation Plan (§703.110)</i> Credit union reports NEV and income simulations with and without derivatives.			
30	<i>Risk Mitigation Plan (§703.110)</i> Credit union includes both parallel and non-parallel changes in rates over the maturity spectrum (both flattening and steepening of the yield curve).			
31	<i>Internal Reporting (§703.105)</i> Ensure the proposed reporting complies with the requirements for a comprehensive derivatives report outlined in the rule.			
32	<i>Internal Reporting (§703.105)</i> Confirm the distribution and frequency of internal reporting.			

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<b>Operational Requirements</b> How a credit union supports and monitors the oversight of a hedging program is critical to its success. The governance and management of ALM activities, including derivatives, requires a greater level of sophistication. In this section, assess how management is conducting activities to support a hedging program and how the internal control framework is supporting those activities. Proper separation of duties, a robust internal control framework and the compliance with GAAP for accounting results are the core attributes for this section.			
33	<i>Board Resolution (§703.106)</i> Review and confirm the board's approval to use derivatives to hedge interest rate risk.		
34	<i>Board Resolution (§703.106)</i> Confirm the approach and method to how both the board and senior executives will receive training.		
35	<i>Senior Executive Officer Oversight (§703.106)</i> Credit union has provided documentation that the senior executive officers will oversee with roles and functional responsibilities in supporting all derivative activities.		
36	<i>ALM Oversight (§703.106)</i> Credit union demonstrates how transactions will be monitored and how the effectiveness of derivative activities is mitigating interest rate risk. Credit union clearly indicates what reporting, systems and functions are being performed, and what sensitivity analysis is being performed, not only for derivatives, but in the context of the overall ALM. Credit union has clearly demonstrated the quality of the reporting and personnel who support these activities.		
37	<i>ALM Oversight (§703.106)</i> Assess the qualifications of the staff that will be supporting derivatives.		
38	<i>ALM Oversight (§703.106)</i> Credit union indicates what reporting and functions are being performed, and what systems are being used.		

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39	<i>ALM Oversight (§703.106)</i> Credit union indicates what sensitivity analysis is being performed, not only for derivatives, but in the context of the overall ALM. Assess the quality of the reporting and personnel who support ALM activities.			
40	<i>Accounting (§703.106)</i> Credit union demonstrates what accounting approach it will use and how it will monitor results over the life of the transactions.			
41	<i>Accounting (§703.106)</i> Assess the qualifications of the staff what will be supporting this function.			
42	<i>Accounting (§703.106)</i> Credit union demonstrates that hedge accounting results will be continually tested for effectiveness, secure required documentation, and record appropriate accounting using an approach that is consistent with its hedging strategy. Review the policies and procedures for this.			
43	<i>Accounting (§703.106)</i> Review the policies and procedures provided by the credit union to confirm that the suggested accounting approach is consistent with the hedging strategy.			
44	<i>Financial Statement Audit (§703.106)</i> Credit union demonstrates that a year-end financial statement audit will be performed inclusive of all derivatives activities.			
45	<i>Internal Controls (§703.106)</i> Credit union confirms that an independent assessment of internal controls will be conducted for the first two years of the program, and provides a confirmation from the internal audit group or auditors.			
46	<i>Process Framework (§703.106)</i> Credit union's internal control framework documents the roles and responsibilities for all the activities needed to support derivative activities, including the separation of duties.			

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47	<i>Process Framework (§703.106)</i> Analyze the depth and robustness of the roles, personnel and controls as the focus of this review.			
48	<i>Separation of Duties (§703.106)</i> Credit union's internal control framework documents the roles and responsibilities for all the activities needed to support derivative activities, including the separation of duties.			
<b>Application Assessment Conclusion and Recommendation (Final Approval)</b>				
49	Is the application content and business plan sufficient enough to determine that the credit union could control a derivatives program?			
50	Given the information that has been presented to me, and in consultation with the other panel member and field office staff, I recommend to <b>approve/decline</b> this application.			
51	<b>Joint panel recommendation for final authority (approve or decline)</b>			