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April 3, 2012

National Credit Union Administration
Attn: Mary Rupp, Secretary of the Board
1775 Duke Street
Alexandria, VA 22317-3428

Dear Ms. Rupp:

ESL Federal Credit Union, located in Rochester, NY and serving over 300,000 members, appreciates this opportunity to comment on the National Credit Union Administration Board's second Advance Notice of Proposed Rulemaking on Financial Derivatives Transactions to Offset Interest Rate Risk: Investment and Deposit Activities (the "ANPR").

In 2000, ESL was approved to participate in the NCUA's Part 703 pilot program for investing in derivatives as hedges to mitigate interest rate risk ("IRR"). The approval allows us independent authority to invest in derivatives, but is strictly limited by the pilot program's parameters to invest in interest rate swaps, caps and floors. The maturity for each derivative cannot exceed 5 years. The approval also capped the total notional amount for all derivative investments. Moreover, the approval limited our counterparties to the members of the Federal Home Loan Bank Board ("FHLB"). Pursuant to the approval, the NCUA Regional Director has the authority to evaluate and approve other counterparties on a case-by-case basis upon a request from ESL. Currently, the FHLB does not offer derivatives as an investment choice and ESL has not been approved to invest with any other counterparty.

You pose several questions in the ANPR. The following are our responses to several of these questions:

Question 1: Should the Board require an FCU to demonstrate a material IRR exposure or another evident risk management need before it is granted independent derivatives authority?

1. We do not think that a credit union should have to wait for IRR exposure to exist on its balance sheet before it can apply or be approved for independent derivatives power. Derivatives are best used to mitigate IRR prior to actual exposure. Requiring exposure prior to considering an application or granting

approval will limit a federal credit union's ability to accept and manage risk in the normal course of business. The cost for a derivative investment acquired after the risk appears on a federal credit union's balance sheet could be prohibitively expensive and as a result would not be purchased. Therefore, a system that requires risk to exist before hedging the risk would be of little value.

Question 2: Is it appropriate to require minimum performance levels, as measured, for example, by CAMEL ratings and net worth classifications, when considering whether to grant or deny an FCU's application to independently engage in derivatives transactions? If so, what performance measures are appropriate and what should those levels be?

2. Yes, it is appropriate for a credit union to be able to show an ability to accept and manage risk through measures of its performance. We caution that the requirements should not be so extreme that they prevent credit unions with strong experience and IRR management needs from obtaining independent authority. We support the use of CAMEL ratings as one appropriate measure to consider when granting an application. We suggest that the federal credit union CAMEL rating should be a composite 1 or 2 as a pre-requisite for approval.

Question 3: What is the minimum kind and amount of derivatives experience and expertise that an FCU's staff should demonstrate before the FCU receives independent derivatives authority? For example, if an FCU has a less complex balance sheet, is it sufficient for that FCU's staff to demonstrate a minimum of three years transacting derivatives? Should NCUA require additional kinds and amounts of experience when there is more complexity in the FCU's balance sheet (e.g., prepayments and call options)? To what extent should an FCU seeking independent derivatives authority be allowed to rely on an outside party to fulfill an experience and expertise requirement?

3. The experience should be commensurate with the risk inherent in the federal credit union's balance sheet and the derivatives investments/positions being used to mitigate IRR. As time is not always coincident with experience, we believe that mandating specific years of experience is not an effective or appropriate measure. The types of derivatives investments transacted by the person and the purposes for using such investments should be the focus of the experience rating, not merely an arbitrary time element.

We also support the ability to use an outside third party as a means of augmenting the level of internal expertise and experience. Assuming a federal credit union performs appropriate vendor due diligence, the use of a qualified third party can be a useful option to allow a federal credit union to increase its current staff knowledge and experience in derivatives. It will allow a federal credit union to choose whether it is more economically feasible to hire a third party or to hire the level of permanent staff.

Question 4: Should FCUs be limited to using interest rate swaps and interest rate caps to offset and manage IRR? Should interest rate swaps be limited to pay-fixed/receive-floating instruments? What other limits should be established to ensure that an FCU does not transact interest rate derivatives in an amount greater than the level of its IRR exposure?

4. Interest rate swaps and caps are not the only derivatives tools that should be permissible investments for credit unions. However, limiting derivatives to interest rate based hedges is warranted because the potential benefits to be gained by a federal credit union from investing in derivatives for other purposes are outweighed by the risks of losses.

We agree that little IRR benefit is derived from credit swaps. However, limiting the structures to plain vanilla pay-fix/receive-floating swaps and interest rate caps is unwarranted because these tools do not sufficiently provide a federal credit union with the tools needed to mitigate all the IRR it can find on its balance sheet.

Pay-floating/receive-fixed swap contracts are commonly used by liability sensitive entities, and floor structures can be effectively used to mitigate call risk in agency structures and mortgage-based products where prepayment risk is a factor.

Additionally, the length of the contract should not be limited. The option to forward start the contracts should be allowed. Swaptions, forwards and futures should also be permitted as they can provide a federal credit union with the flexibility to match the timings of the derivative investments payments with the IRR it is attempting to mitigate.

As an overarching comment on the use of derivative instruments, we believe they should be viewed by NCUA in the same light as investment management and asset liability management.

Question 5: Should NCUA establish exposure limits for FCUs or should it require an FCU's board of directors to establish exposure limits? Should there be limits on the aggregate amount of each type of derivatives instrument in the portfolio or on the aggregate amount of derivatives transacted with any counterparty? Should limits be based on the notional amount of a derivatives instrument, its mark-to-market valuation, or both?

5. The credit union's board of directors should establish its credit union's exposure limits to its derivative positions. The aggregate amount of exposure should be expressed in mark-to-market terms and should be netted against other comprehensive income ("OCI") positions.

If you have any questions about the contents of these comments or would like to discuss this matter with us, please contact either James Darcy at 585.336.1054 or jdarcy@esl.org or me at 585.336.1171 or pwoods@esl.org.

Thank you very much for your consideration of this matter.

Very truly yours,

Peter R. Woods
Associate General Counsel
ESL Federal Credit Union