June 3, 2016

Mr. Robert deV. Frierson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Re: Docket No. R–1534 and RIN No. 71

Dear Sir:

I. Introduction

This comment letter is submitted by the Council of Federal Home Loan Banks (Council), a trade association, on behalf of its members, the eleven Federal Home Loan Banks (FHLBanks). It is being submitted in response to the Notice of Proposed Rulemaking published in the Federal Register on March 16, 2016, entitled "Single-Counterparty Credit Limits for Large Banking Organizations" ("Proposed Rule").[1] The proposal is designed to implement section 165(e) of the Dodd-Frank Wall Street Reform and Consumer Protection Act,[2] which requires the Board to impose limits on the amount of credit exposure that certain bank holding companies and foreign banks (covered companies) may have to an unaffiliated company (the "counterparty") in order to reduce the risks arising from the counterparty's failure. Section 165(e)(6) explicitly excludes the FHLBanks from the provisions of section 165(e), and in addition authorizes the Federal Reserve Board to exempt transactions from the definition of a "credit exposure" when the Board determines that such an exemption is in the public interest and consistent with the purposes of the provision.

The FHLBanks are government-sponsored enterprises of the United States, organized under the authority of the Federal Home Loan Bank Act of 1932, as amended, and structured as cooperatives. Each FHLBank is independently chartered and managed, but the FHLBanks issue consolidated debt obligations for which each FHLBank is jointly and severally liable

[1] 81 Fed. Reg. 14328 (2016).
[2] 12 U.S.C. 5365(e)

(Consolidated Obligations). The capital stock of each FHLBank is registered with the Securities and Exchange Commission (SEC) under the Securities Exchange Act of 1934. The FHLBanks serve the general public interest by providing liquidity to approximately 7,000 member financial institutions, thereby increasing the availability of credit for residential mortgages, community investments, and other services for housing and community development. The FHLBanks' member institutions, which include banks, savings institutions, credit unions, community development financial institutions, and insurance companies, are also their shareholders. The FHLBanks provide readily available, low-cost sources of funds to their member financial institutions through loans referred to as "advances." In addition, some FHLBanks also purchase and hold residential mortgage loans from their member financial institutions.

The FHLBanks' cooperative business model has enabled them to support their members' liquidity and risk management needs safely and soundly for 80 years. The FHLBanks have proven to be a reliable source of liquidity throughout all economic cycles. Their critical role as a liquidity provider has been reinforced by the governmental resources made available to them to support their own liquidity, discussed below. Although the FHLBanks' role is different from the Federal Reserve System, the FHLBanks are also well-established as reliable liquidity providers.

II. The 2011 Notice of Proposed Rulemaking

The single-counterparty credit limitation in the current Proposed Rule was previously contained in a broader notice of proposed rulemaking issued in 2011, and published in the Federal Register in January 2012.[3] The preamble to the 2011 proposed rule explained that the proposed regulatory text "implements section 165(e)(6) of the Dodd-Frank Act, which provides an exemption for FHLBanks."[4] The preamble did not discuss the extent of the exemption. The regulatory text however, stated: "For purposes of this subpart, a covered company does not include any FHLBank."[5] Thus, the text of the proposed regulation could be interpreted as only exempting FHLBanks from being a "covered company," leaving open the possibility that a covered company could be limited in its ability to hold credit exposures to a FHLBank, such as through Consolidated Obligations or other capital instruments.

Due to the unintended consequences that such an interpretation would have, the FHLBank Presidents submitted a joint comment letter to the Board on April 30, 2012. This letter asked that the final rule include an exclusion of investments in FHLBank Consolidated Obligations and FHLBank capital stock from the single-counterparty credit limits. A copy of this letter is enclosed and we request that it become part of this rulemaking record.

III. Current Notice of Proposed Rulemaking

The current Proposed Rule represents the Board's revisions to the original proposed rule, in light of a number of developments, including the receipt of numerous comment letters, such as

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[3] 77 Fed. Reg. 594 (2012).
[4] Id. at 622.
[5] Proposed § 252.96(b) at 77 Fed. Reg. 654 (2012).

the letter submitted by the FHLBank Presidents.[6] The preamble to the current rulemaking states that "Section 252.77(b) of the proposed rule would implement section 165(e)(6) of the Dodd-Frank Act, which provides a statutory exemption *for credit exposures to* the Federal Home Loan Banks." [7] [Emphasis added]. Unfortunately, the proposed regulatory text was not changed from the earlier version, and simply states that "For purposes of this subpart, a covered company does not include any Federal Home Loan Bank."[8]

For the reasons discussed below, we believe that the regulatory text should be modified to reflect the fact that FHLBanks are not covered companies, and that credit exposures to FHLBanks should not be included in a covered company's aggregate credit exposure.

IV. The FHLBanks Should Be Excluded from All Aspects of the Rule

A. Statutory Language Excludes Exposures to FHLBanks

Section 165(e)(6) of the Dodd-Frank Act states that "This subsection [authorizing single counterparty credit limits] shall not apply to any Federal home loan bank."[9] This exemption is not limited to the scope of what is a covered company. Section 165(e)(6) is a broad exemption from the *entire subsection* that establishes the basis for the single- counterparty credit limitation. If the entire subsection does not apply to the FHLBanks, the Board does not have the statutory authority to limit exposures to the FHLBanks.

This interpretation is consistent with the purpose of section 165(e). According to section 165(e)(1), the subsection was adopted in order to limit the risks to covered companies that would be created through the failure of a significant counterparty. Yet, Congress recognized repeatedly that the FHLBanks do not present the types of risk requiring special provisions. For example, section 165(j), authorizing the Board to establish leverage limits, explicitly excludes the FHLBanks. Likewise, section 171, establishing minimum leverage and risk-based capital ratios, does not apply to the FHLBanks.

B. Federal Home Loan Bank Obligations

Federal Home Loan Bank Consolidated Obligations and other capital obligations should not be included in the credit limit. Consolidated Obligations represent the joint and several liabilities of all eleven FHLBanks. There has never been a loss on any FHLBank obligation. No FHLBank has ever suffered a loss on an advance to a member, reflecting the high collateralization of advances and the fact that the FHLBanks have a statutory lien priority over other creditors. The Federal Housing Finance Agency has robust systems in place to monitor and control the FHLBanks, including the capacity to respond to any financial distress the FHLBank System might encounter. Debt issuance is subject to the approval of the U.S. Treasury. Finally, we note that the Board has included Consolidated Obligations within the

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[6] "The Board received comments on all aspects of the proposed rules. and the Board has taken into consideration these comments in these revised proposed rules for section 165(e)." 81 Fed. Reg. 14329 (2016).
[7] 81 Fed. Reg. 14344 (2016).
[8] Proposed § 252.77(b) at 81 Fed. Reg. 14355 (2016).
[9] 12 U.S.C. 5365 (e) (6).

definition of level 2A, "highly liquid assets," presumably based on their low-risk characteristics, including the FHLBanks' joint and several liabilities.[10] It would seem inconsistent to treat these obligations as "highly liquid" in times of economic stress, but subject to single-counterparty credit limits.

C. The Proposed Rule and the FHLBanks' "Safety Net" Function

The Federal Home Loan Bank System plays a critical role in mortgage finance and as a liquidity provider, especially during times of financial stress. As noted in a Federal Reserve Bank staff report, during the U.S. mortgage crisis of 2008, the Federal Home Loan Bank System was one of the most important national liquidity providers.[11] The FHLBank System has demonstrated over and over again its importance in providing needed liquidity during highly stressful conditions – including to the bank subsidiaries of covered companies. The critical nature of the FHLBanks' role was most recently demonstrated during the 2008 crisis, when outstanding advances sharply increased and eventually peaked at over $1 trillion in the third quarter of 2008.

The FHLBanks can provide this liquidity due to high demand for their Consolidated Obligations. Because of the low credit risk associated with the FHLBanks, demand for these obligations increases during times of economic turmoil. As a result, the FHLBanks can provide necessary liquidity without increasing their own cost of funds. However, by limiting the amount of Consolidated Obligations covered companies may hold, the Proposed Rule would interfere with this liquidity conduit. Interfering with the market for Consolidated Obligations thus runs counter to the role of the Banks as a liquidity provider, and is therefore against public policy.

D. Impact on Use of Consolidated Obligations as Collateral

The deep market in FHLBank Consolidated Obligations, as well as the high credit rating assigned to these securities, makes Consolidated Obligations a convenient and widely used form of collateral for credit exposures. Thus, these securities serve a vital function in the credit and money markets. Consolidated Obligations may also serve as collateral for a wide variety of transactions, and are authorized as derivatives clearinghouse collateral. The Proposed Rule could limit a covered company's appetite for accepting Consolidated Obligations (or other debt securities) as collateral because it would generally require the covered company to include the credit exposure to the collateral issuer as counterparty credit exposure, resulting in unanticipated additional counterparty credit exposure subject to the Proposed Rule's credit limits.[12] This is likely to have a negative effect on a whole host of collateralized transactions, including cleared and uncleared derivatives, repurchase agreement transactions, and any other transaction for which high-quality, highly liquid assets are desired to serve as collateral. The increased burden placed on collateralized transactions would increase financing costs for financial institutions and ultimately consumers, and could further impair the use of Consolidated Obligations generally. In addition, the high credit quality of FHLBank System obligations makes these debt securities

[10] 79 Fed Reg. 61440 (2014).
[11] Federal Reserve Bank of New York, Staff Report No. 357, "The Federal Home Loan Bank System: Lender of Next to Last Resort." (Nov. 2008).
[12] *See* proposed § 252.174(c)(2).

popular investments for money market funds and other investment vehicles. As of April 30, 2016, approximately 38% of all Consolidated Obligations then outstanding were held by money market funds, amounting to roughly $343 billion. Another unintended consequence of the proposed regulation is that it might limit covered companies from investing in safe and highly liquid money market funds and similar alternatives.

E. Acquisition of Capital Stock Should Not Be Restricted

The Proposed Rule may also be interpreted as applying single-counterparty credit limits to holdings of FHLBank capital stock. However, FHLBank members are statutorily required to hold a minimum amount of capital stock as a condition of membership and, as needed, to purchase additional capital stock as a condition of borrowing from an FHLBank (in a specified proportion to the borrowing). Thus, unless clarified, the proposal's credit exposure limits could have the effect of limiting a member's ability to borrow from an FHLBank, if a borrowing would cause its aggregate holdings of Consolidated Obligations and FHLBank capital stock to exceed those limits. Moreover, since the FHLBanks are organized like cooperatives, their capital stock may only be issued, transferred, repurchased or redeemed by the FHLBank at its stated par value (subject to certain conditions).[13] Thus, capital stock presents low market and credit risk to covered companies.

F. The Proposed Rule Increases Systemic Risks By Including the FHLBanks

In addition to Consolidated Obligations, many covered companies carry FHLBank exposures related to other FHLBank financial activities. For example, the FHLBanks use interest rate derivatives to manage their interest rate risk, and some FHLBanks also trade in the To Be Announced markets to manage the interest rate risks posed by their whole mortgage loan purchase operations.[14] Similarly, the FHLBanks manage the risk posed by their excess liquidity through the Federal Funds and repurchase markets. Many covered companies serve as counterparties to the FHLBanks in these key risk management transactions. By counting such exposures against these covered companies' credit exposure limit, the Proposed Rule is indirectly limiting the FHLBanks' ability to engage in these risk-reducing transactions with covered companies, which may have the unintended effect of reducing the FHLBanks' ability to meet their statutory mission in a safe-and-sound manner. This in turn increases the risk to all FHLBank members (including the bank affiliates of many covered companies) a circumstance that section 165(e)(6) of the Dodd-Frank Act sought to prevent by excluding the FHLBanks from subsection 165(e).

[13] The Proposed Rule would count the market value of equity securities held by a covered company towards that company's aggregate single-counterparty credit limit. Since there is no "market" for FHLBank capital stock (other than redemption at par), it makes little sense to include it in the covered company's credit limit.

[14] Similar considerations apply to FHLBank letters of credit, which are issued to support public unit deposits, FHLBank members, and specific transactions. Because FHLBank letters of credit also constitute credit exposure, accepting a letter of credit reduces the covered counterparty's ability to extend other credit to the FHLBank.

G. Unequal Treatment Compared to FNMA and FHMLC

The Proposed Rule explicitly provides an exemption from the credit cap for claims on or guaranteed by FNMA and FHMLC (the "Enterprises"), while those companies are operating under the conservatorship or receivership of the Federal Housing Finance Agency. In addition, the proposal does not include as a credit exposure unused lines of credit that would be collateralized by obligations issued or guaranteed by the Enterprises when drawn upon, provided these entities are operating under a Federal Housing Finance Agency conservatorship or receivership. Similar treatment is not expressly provided for obligations of the FHLBanks.[15]

The preamble explains that this special treatment for the Enterprises is appropriate because "This approach is consistent with the approach that the Board used in its risk retention rules." This reason does not support the determination to treat FNMA and FHLMC differently than the FHLBanks. The risk retention rule relates to the risks inherent in asset-backed securities, which are distinct from the risk that the Enterprises may fail. The goal of the risk retention rule is to discourage a securitizer from surreptitiously putting poorly underwritten loans into the portfolio collateralizing the security. The risk retention rule has nothing to do with the *credit quality* of the asset-backed security, other than to prevent or limit the fraudulent activity. An asset-backed security, or a tranche of an asset-backed security, can have a low credit rating (indicating high credit risk) whether or not the risk retention rule applies. Thus, the fact that the Enterprise obligations are exempt from the risk retention requirements has no relationship to the financial health of the Enterprises or to the credit quality of an Enterprise obligation, whether it is a mortgage-backed security guaranteed by an Enterprise or the obligation is an uncollateralized debt instrument issued by one of the Enterprises.

While the stated reason for providing special treatment does not appear to be related to the proposed regulation, it would be entirely appropriate for the Board to determine that the Enterprises and the FHLBanks are vital elements to our housing finance markets, and that for the public policy reasons explained above, the obligations of all three legs of our housing finance system should be exempt from the credit limit cap.

In addition, failure to exempt covered companies' credit exposure to the FHLBanks, while exempting Fannie Mae and Freddie Mac, could have the unintended consequence of signaling to the markets a regulatory preference for Fannie Mae and Freddie Mac debt over FHLBank consolidated obligations. This may widen spreads on FHLBank consolidated obligations, thereby putting the FHLBanks at a competitive disadvantage in meeting their housing and liquidity mission, and at minimum increasing their costs.

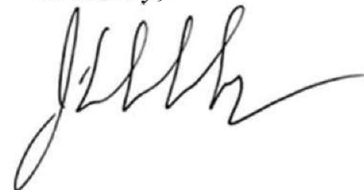
V. Conclusion

The statutory exemption for the FHLBanks in section 165(e)(6) was intended to ensure that the Banks are not limited in their ability to lend to members and are able to fulfill the FHLBanks' liquidity mission. Accordingly, the Final Rule should expressly exclude all credit

[15] The Proposed Rule explains that the Board would consider similar treatment for other Government-Sponsored Entities, presumably by specific order in the future.

exposure to the FHLBanks, and in particular investments in FHLBank Consolidated Obligations and capital stock, from the single-counterparty credit limits in the proposed regulation. We, therefore, urge that the final regulation make clear that these exposures are not included when calculating a covered company's total credit exposure.

Sincerely,



John von Seggern
Council of FHLBanks
President and CEO

cc: The Presidents of the Eleven Federal Home Loan Banks
Federal Housing Finance Agency Office of General Counsel