

January 31, 2014

**BY ELECTRONIC SUBMISSION**  
**AT WWW.REGULATIONS.GOV**

Legislative and Regulatory Activities Division  
Office of the Comptroller of the Currency  
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Suite 3E-218, Mail Stop 9W-11  
Washington, DC 20219  
Docket ID OCC-2013-0016

Mr. Robert deV. Frierson, Secretary  
Board of Governors of the Federal Reserve System  
20th Street and Constitution Avenue NW  
Washington, DC 20551  
Docket No. R-1466

Mr. Robert E. Feldman  
Executive Secretary  
Attention: Comments/Legal ESS  
Federal Deposit Insurance Corporation  
550 17th Street NW  
Washington, DC 20429  
RIN No. 3064-AE04

**Re: Proposed Rule — Liquidity Coverage Ratio: Liquidity Risk Measurement,  
Standards, and Monitoring**

Dear Sir or Madam:

On behalf of the undersigned Federal Home Loan Banks (“FHLBanks”), we appreciate this opportunity to comment on the above-referenced proposed rule (the “Proposed Rule”) published by the Office of the Comptroller of the Currency (“OCC”), the Board of Governors of the Federal Reserve System (“Board”), and the Federal Deposit Insurance Corporation (“FDIC”, and together with the OCC and Board, the “Agencies”) in the Federal Register on November 29, 2013. The Proposed Rule would implement a quantitative liquidity requirement consistent with the liquidity coverage ratio (“LCR”) standard established by the Basel Committee on Banking Supervision (“BCBS”). This letter responds to several questions that the Agencies have posed in the preamble to the Proposed Rule relating to issues that impact FHLBank member institutions and the mission of the FHLBanks in supporting the housing market and community

development. The relevant questions that the Agencies have raised are included below in this letter along with the corresponding responses.

### ***The FHLBanks***

The twelve 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 regional cooperatives. Each FHLBank is independently chartered and managed, but the FHLBanks collectively issue their consolidated debt obligations (“FHLBank Consolidated Obligations”) for which each is jointly and severally liable. The FHLBanks serve the general public interest by providing liquidity to over 7,500 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 funds to their member financial institutions through secured loans referred to as “advances.”

### **High Quality Liquid Assets**

Under the Proposed Rule, the Agencies have established three levels of high quality liquid assets (“HQLAs”). Level 1 liquid assets are not subject to haircuts and may be included in the HQLA calculation without limit. Level 2A liquid assets are subject to a 15 percent haircut and capped at 40 percent of total HQLAs when combined with level 2B liquid assets, and level 2B liquid assets are subject to a 50 percent haircut and capped at 15 percent of total HQLA. Debt securities issued and guaranteed by a U.S. government-sponsored enterprise (“GSE”) are categorized as level 2A liquid assets under the Proposed Rule.

***Question 14. What alternative treatment, if any, should the agencies consider for obligations of U.S. GSEs and why? Provide justification and supporting data.***

While we appreciate that GSE obligations are included as HQLAs, we request that the Agencies include GSE obligations in the level 1 liquid asset category. A requirement for level 1 liquid assets under the Proposed Rule is that the assets have the highest potential to generate liquidity for a covered company during periods of severe liquidity stress. U.S. Treasuries, certain securities issued by sovereign entities and other assets that the Agencies have deemed to have the highest potential to generate liquidity during periods of market stress are included in the category of level 1 liquid assets.

FHLBank Consolidated Obligations, like U.S. Treasuries, are recognized in the market as safe and highly liquid investments and have performed extremely well during periods of severe liquidity stress. Historical data shows that FHLBank Consolidated Obligations have been treated similarly to U.S. Treasuries during high-stress periods in the markets and thus have performed in a manner consistent with level 1 liquid assets in that respect even though the FHLBank Consolidated Obligations are not obligations of the United States and are not directly guaranteed

by the United States or any government agency. Chart 1 of Exhibit A illustrates the correlation between the volume of FHLBank discount notes and U.S. T-bills during the first decade of the 21<sup>st</sup> century, including during the recent financial crisis.

During the financial crisis of 2007–2009, demand for FHLBank Consolidated Obligations increased as investors sought what they considered to be the most stable, highest quality investments available in the market. Chart 2 of Exhibit A shows a significant spike in the issuance of FHLBank Consolidated Obligations during the most critical period of the recent financial crisis. In contrast to FHLBank Consolidated Obligations, the performance of securities issued by certain sovereign entities that are included in the level 1 liquid asset classification declined at various points in 2008. Furthermore, the spread of top tier European sovereign debt to the German benchmark, as illustrated in Chart 3 of Exhibit A, has been much more significant than the spread of FHLBank Consolidated Obligations to the yield of U.S. Treasuries, as illustrated in Charts 4-6 of Exhibit A.

Historically, FHLBank Consolidated Obligations have maintained the same ratings as U.S. government obligations and have been viewed in the markets as low-risk, high-quality investments. In addition to having performed well during historical periods of stress, FHLBank Consolidated Obligations are generally considered by investors to be highly liquid and readily marketable. They are currently underwritten and sold by over 65 active dealers.

The data illustrates that FHLBank Consolidated Obligations have historically performed as well as or better than many other classes of assets that are included as level 1 liquid assets under the Proposed Rule. We note that under the level 2A classification of the Proposed Rule, FHLBank Consolidated Obligations are subject to a 15 percent haircut and 40 percent cap of total HQLAs (when combined with level 2B liquid assets) whereas comparable level 1 assets are not subject to a haircut or cap. Given that FHLBank Consolidated Obligations perform on par with level 1 liquid assets, we see no clear justification for limiting the value and volume of FHLBank Consolidated Obligations or for the disparate treatment of these categories of assets. Therefore, we request that the Agencies classify FHLBank Consolidated Obligations as level 1 liquid assets, or if not feasible, that the 40 percent cap be increased and the haircut be reduced to reflect that a 15 percent haircut significantly exceeds any likely value loss on FHLBank Consolidated Obligations.

***Question 15. What, if any, additional criteria should the agencies consider in determining the type of securities that should qualify as level 2B liquid assets? What alternatives to the S&P 500 should be considered in determining the liquidity of an equity security and why?***

The Proposed Rule includes certain publicly-traded corporate debt securities and publicly-traded shares of common stock under the category of level 2B assets. However, no other types of assets are included in this category. The exclusion of mortgage-related assets is particularly noteworthy. FHLBanks play an important role in supporting housing finance and recognize the increasing importance of residential lending in our economy. We are concerned that the exclusion of mortgage-related assets from HQLAs could hinder the recovery of the housing market. As drafted, the Proposed Rule could be interpreted as discouraging residential

mortgage credit extensions, prompting banking institutions to limit such investments and replace them on their balance sheets with higher concentrations of U.S. Treasuries, agency securities, sovereign debt, GSE obligations and corporate debt and equities. Further, the exclusion of mortgage-related assets from HQLA treatment could cause a devaluation of such assets, increasing the costs of sustainable housing opportunity.

*Non-agency residential mortgage-backed securities (“RMBS”)*

RMBS are omitted from level 2B liquid assets under the Proposed Rule despite the fact that the BCBS has adopted an LCR standard that specifically includes RMBS in the level 2B category of assets, subject to a 25 percent haircut, rating requirements and certain other qualifying characteristics to ensure the quality of such assets. When value is attributed to RMBS, financial institutions are able to use the funds they accumulate from the sale of such assets to generate additional residential mortgages and to further improve liquidity in the mortgage market and economy as a whole. Small business owners, for example, frequently utilize mortgage assets to support borrowings for their businesses. If maintaining mortgage-related assets on their balance sheets could adversely affect the LCRs of covered financial companies, they might reduce their lending activities or significantly increase the cost of credit in certain sectors, thereby directly impacting the housing market and other aspects of the economic cycle. Additionally, if other jurisdictions adopt HQLA standards more consistent with the BCBS proposal, covered companies in the U.S. would be at a disadvantage, needing to restructure their balance sheets in certain business lines to accommodate the exclusion of RMBS investments from their LCR calculations.

Given the overall benefits to the covered companies and the economy of including RMBS as HQLAs, we request that the Agencies add these assets to the level 2B liquid asset category. RMBS issuances have benefitted from the improved quality of mortgages available in the market as well as the more prudent underwriting standards that have been implemented generally in connection with financial reform efforts. As the BCBS has demonstrated, appropriate haircuts and characteristics can be assigned to RMBS to ensure that this pool of mortgage-related assets is of sufficient quality to be included as HQLAs. In addition, the inclusion of RMBS in a category of HQLAs would allow financial institutions to continue to support the growth of the U.S. housing market and retain beneficial current practices in that particular sector.

*Mortgage Loans*

Mortgage loans are excluded from all categories of HQLAs under the Proposed Rule without taking into consideration the quality of certain mortgages and the important role mortgages play in the economy. As is illustrated in the OCC’s 18th annual “Survey of Credit Underwriting Practices,” underwriting standards tightened significantly for retail products such

as residential real estate loans during the period between 2008 and 2010.<sup>1</sup> While there has been a slight easing of underwriting standards, credit risk on residential loans remains significantly improved compared with residential loans originated prior to the financial crisis. Certain protections have also been put in place in the housing industry to improve the quality of mortgage-related assets and to encourage the infusion of private capital into the mortgage market. In particular, the qualified mortgage (QM) rule, which became effective on January 10, 2014, is designed to ensure that appropriate underwriting standards are used in connection with the origination of mortgages in the U.S. The QM rule requires lenders to make a reasonable, good faith determination of a consumer's ability to repay home loans before extending credit and outlines specific underwriting guidelines designed to help creditors support their ability-to-repay determinations. Although these laws are relatively new, they should help improve the quality of mortgage assets over time and increase the value and liquidity of any whole loans that would be included in the pool of HQLAs in the future.

### Other Assets

The Agencies note in the preamble to the Proposed Rule that HQLAs should only include assets that can be converted easily into cash. Moreover, the asset cannot be pledged, explicitly or implicitly, to secure or provide credit-enhancement to any transaction, except that the asset can be pledged to a central bank or a GSE to secure potential borrowings if credit secured by the asset has not been extended to the covered company or its consolidated subsidiaries. This exception permits collateral that is covered by a blanket lien from a U.S. GSE to be included in HQLAs.

We support the exception to the unencumbered assets requirement for HQLAs that permits assets pledged to GSEs to be utilized as HQLAs. However, we request that the Agencies also consider expanding HQLAs to allow any assets that are pledged to FHLBanks in support of FHLBank advance availability to be categorized as HQLAs rather than only those assets that are currently specified as level 1, 2A and 2B liquid assets. The FHLBanks accept eligible collateral to support the advances they provide to members, thereby helping their member institutions liquefy such assets on their balance sheets. An attribute of a member institution's FHLBank eligible collateral that makes it highly liquid is its ability to be quickly converted into cash advances from an FHLBank. The collateral accepted by FHLBanks is high-quality collateral and must be eligible to be accepted by FHLBanks under their regulations. This collateral generally includes cash, FHLBank deposits, U.S. Treasuries, agency securities, certain qualifying mortgage loans and other real-estate related collateral that requires the approval of the regulator of the FHLBanks, the Federal Housing Finance Agency.

Under the Proposed Rule, covered companies may have an incentive to borrow funds in order to purchase U.S. Treasuries and other HQLAs. This practice would ultimately remove funds from the loan market that could be used for housing finance. The Agencies could support

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<sup>1</sup> See Office of the Comptroller of the Currency, "2012 Survey of Credit Underwriting Practices" (June 2012)

mortgage lending by recognizing all eligible collateral that has been posted by a member institution to an FHLBank for advance availability as HQLAs under the Proposed Rule. Acknowledging this source of liquidity, subject to appropriate haircuts, would allow FHLBank member institutions to retain collateral that can be easily converted into cash advances through the FHLBanks and to continue to utilize FHLBank advances for additional community lending rather than the acquisition of additional HQLAs.

### Provisional Liquidity

If the Agencies determine that RMBS and safe and prudently underwritten whole loans that are on the balance sheets of covered companies are not suitable to be included in the level 2B liquid asset category, we request that an additional category of assets be added under the final rules that would permit future opportunities for residential mortgages and other types of assets to be included as HQLAs. For example, under an additional category or tier of HQLAs, the Agencies would not need to include a list of specified assets. Instead, the rule could simply provide that covered companies may apply to the Agencies using supporting data for specific assets and request a determination that such additional assets be included in the new tier of HQLAs, provided that such additional assets have a solid indicia of stability in the market and can easily be converted into cash during times of financial stress.

### FHLBank Advance Availability

The BCBS recently agreed to modify the definition of HQLA under its LCR proposal to allow contractually committed liquidity facilities provided by central banks to be included as level 2B liquid assets, subject to a range of conditions and limitations. This was in part because central banks have served a role as lenders of last resort. We request that FHLBank collateralized advance availability be included as level 2B liquid assets because, like central banks, FHLBanks have had the distinguished position of serving as the lenders of last resort during crisis periods. This role is highlighted in a 2008 Federal Reserve Bank of New York Staff Report that details the critical role the FHLBanks served as the lenders of “next-to-last resort” in the most recent credit crisis.<sup>2</sup>

During the recent credit crisis, FHLBank advances were a vital source of liquidity to their member institutions. The Federal Reserve Bank of New York Staff Report acknowledged that the FHLBanks were among the first institutions to emerge as an important provider of government-sponsored liquidity during the crisis. In fact, advances to FHLBank members increased from \$640 billion in June 2007 to over \$1.0 trillion in September 2008, an increase of \$372 billion or 58 percent.<sup>3</sup> As noted in the discussion regarding FHLBank Consolidated Obligations above, the increased demand for FHLBank debt during periods of stress allowed the

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<sup>2</sup> See Adam B. Ashcroft, Morten L. Bech and W. Scott Frame, “The Federal Home Loan Bank System: The Lender of Next-to-Last Resort?,” Federal Reserve Bank of New York Staff Reports, Number 357 (November 2008).

<sup>3</sup> See *id.*

FHLBanks to access the markets continuously throughout the credit crisis. Thus, FHLBanks were able to meet their members' needs for liquidity during a period when alternative sources were not available to such institutions.

The FHLBanks have a proven track record of providing liquidity during times of market stress, and such liquidity is supported by the collateral posted to the FHLBanks. The FHLBanks are well positioned to respond to their members' liquidity needs during crisis periods, and treatment of FHLBank collateralized advance availability as HQLAs under the final rule would be consistent with the reliability of these sources of funding during past periods of economic stress.

### **Total Net Cash Outflow**

In calculating the LCR under the Proposed Rule, covered companies are required to apply the most conservative treatment with respect to inflows and outflows. This conservative treatment includes the interpretation of various contract provisions as outlined in the Proposed Rule. We believe clarification is needed regarding the assumptions about contractual clauses that are outlined in the preamble and Proposed Rule, including acceleration options and material adverse change clauses.

***Question 30. The agencies solicit commenters' views on the proposed treatment for maturing instruments and for determining the date of transactions. Specifically, what are commenters' views on the proposed provisions that would require covered companies to apply the most conservative treatment with the respect to inflow and outflow dates and embedded options?***

Under the Proposed Rule, the earliest possible contractual maturity date must be used when calculating inflows and outflows, taking into account options that could accelerate the maturity date or the date of the transaction. While we understand the purpose of this approach, we believe additional clarification is needed since acceleration is a general concept used in countless credit agreements. For example, acceleration is used frequently in loan documents as a remedy that can be exercised if the borrower fails to honor its obligations and an event of default is triggered under the credit agreement. Because acceleration provisions are regularly used in the default context in banking industry documents, it is important to eliminate interpretations of the Proposed Rule that would inadvertently result in the maturity dates of most credit agreements being deemed to have been accelerated.

Because acceleration provisions are standard in event of default contexts, it would follow that the maturity concept in the Proposed Rule was not intended to cover such acceleration provisions but rather was meant to address acceleration options in transactions in which one party has a contractual right to accelerate maturity or change similar terms of the transaction on a specified date or upon the occurrence of a specified condition other than an event of default. In essence, the acceleration provisions to which the Proposed Rule would apply are those in which there has been a benefit of the bargain for the right to accelerate the maturity or other terms under specified circumstances. We request that the Agencies clarify that the right to accelerate

in the case of an event of default is not an acceleration option for purposes of the LCR calculation.

***Question 45. What are the operational difficulties in identifying the collateral outflows related to changes in financial condition? What, if any, additional factors should be considered?***

In the preamble to the Proposed Rule, contracts with material adverse change (“MAC”) clauses and downgrade triggers are described as contracts that capture changes in a covered company’s financial condition and would require a covered company to post more collateral or accelerate a demand feature in certain obligations that require collateral. The Proposed Rule would require 100 percent outflow of all additional amounts that would need to be posted or funded as a result of a change in financial condition under such contracts.

We agree that ratings downgrades are frequently viewed as proxies for a company’s financial condition and can trigger additional collateral obligations under contracts. A rating downgrade is an observable change that can often lead to adjustments in thresholds or other aspects of a contract resulting in an additional collateral requirement. However, MAC clauses are notably different from ratings downgrade triggers as they require a more subjective analysis. MAC clauses are not generally the sole reason for triggering additional collateral obligations under contracts. Therefore, we seek clarification to confirm that the Agencies do not view the mere presence of a MAC clause in a contract as a provision that would be expected to impact the calculation of outflows.

***Question 54. The agencies solicit commenters’ views on the proposed treatment of secured funding activities. Do commenters agree with the proposed outflow rates as they relate to the collateral? Why or why not? Should municipal and other public sector entity deposits be treated as secured funding transactions?***

The preamble to the Proposed Rule states that “rather than applying an outflow treatment that is based on the nature of the funding provider, the proposed rule would generally apply a treatment that is based on the nature of the collateral securing the funding.” Nevertheless, under §\_32(j)(iii) of the text of the Proposed Rule, there is a fixed outflow rate of 25 percent for secured funding transactions with sovereign, multilateral development banks, and U.S. government-sponsored enterprises that are assigned a risk weight of 20 percent, such as the FHLBanks. Due to the general nature of the commentary in the preamble to the Proposed Rule, we would like to confirm that FHLBank advances, which would be considered secured funding, are intended to be subject to a maximum outflow rate of 25 percent.

Based on the demonstrated availability of FHLBank advances during times of economic stress when other credit facilities and sources of funding were unavailable, we also request that the Agencies consider lowering the maximum outflow rate of FHLBank advances from 25 percent to 3 percent, which is consistent with the outflow rate for stable retail deposit balances. The involuntary outflow rate for FHLBank advances has been virtually zero historically. As such, FHLBank advances have proven to be as dependable as retail deposits and should receive similar treatment. FHLBanks have a history of working with the regulators of their member

institutions to support the liquidity needs of those institutions during times of stress. Additionally, FHLBanks' ability to accept less liquid forms of collateral has allowed them to roll over advances so that member institutions are able to receive continuous funding without any requirements to substitute the posted collateral with assets representing level 1 liquid assets.

In addition to reviewing the outflow treatment of FHLBank advances, we request that the Agencies clarify that FHLBank guarantees, including guarantees such as letters of credit that support municipal deposits, will be subject to the same outflow rate as FHLBank advances. All FHLBank guarantees, like advances, are fully collateralized and are treated as reliable sources of liquidity in the markets. Such guarantees are recognized as eligible collateral in virtually every state in the U.S. and are granted the same treatment as U.S. Treasuries and agency securities by most public entities. Unlike securities collateral, which must be liquidated in the market and is subject to valuation movement, FHLBank guarantees are payable at par value upon demand of the depositor or beneficiary. Moreover, FHLBank guarantees, if drawn or terminated, can be readily converted into advances by FHLBank member institutions thereby giving them immediate access to the cash equivalent of the guarantee at par value if ever needed.

***Question 60. What, if any, additional items the agencies should explicitly exclude from inflows? What, if any excluded items should the agencies consider including in inflows? Please provide justification and supporting information.***

In the calculation of a covered company's LCR, the denominator takes into account the difference between a covered company's cumulative cash outflows and cumulative cash inflows. Any determination of cash inflows must exclude lines of credit as well as any amounts arising from a credit or liquidity facility extended to a covered company. The rationale provided for this exclusion is that in a stress scenario, inflows from such facilities might not materialize, or even worse, a stress at one institution could result in additional strain throughout the financial system if that company draws down its lines of credit.

We acknowledge the concerns the Agencies have raised regarding allowing lines of credit to be included in the LCR calculation. However, FHLBanks serve a unique function in supporting lending and liquidity of financial institutions in the U.S. The FHLBanks have been a stable source of funding even in times of stress and did not experience the strains in funding their advances that other financial institutions encountered in funding their lines of credit during the recent credit crisis. In fact, U.S. financial institutions were successfully able to increase liquidity through FHLBank advance borrowing during the financial crisis of 2007–2009. FHLBank advances should continue to be an invaluable source of liquidity in future crises. Accordingly, member financial institutions that have lines of credit with the FHLBanks should be allowed to count such a valuable source of liquidity towards their inflows.

We appreciate this opportunity to provide comments on this important rulemaking process and appreciate your consideration of these comments.

Sincerely,

**Federal Home Loan Bank of Atlanta**



W. Wesley McMullan  
President and Chief Executive Officer

**Federal Home Loan Bank of Boston**



Edward A. Hjerpe III  
President and Chief Executive Officer

**Federal Home Loan Bank of Chicago**



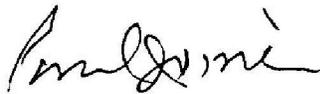
Matthew R. Feldman  
President and Chief Executive Officer

**Federal Home Loan Bank of Cincinnati**



Andrew S. Howell  
President and Chief Executive Officer

**Federal Home Loan Bank of Dallas**



Paul Joiner  
Interim President and Chief Executive Officer

**Federal Home Loan Bank of Des Moines**



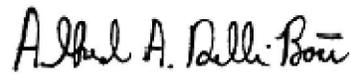
Richard S. Swanson  
President and Chief Executive Officer

**Federal Home Loan Bank of Indianapolis**



Cindy L. Konich  
President - Chief Executive Officer

**Federal Home Loan Bank of New York**



Alfred A. DelliBovi  
President and Chief Executive Officer

**Federal Home Loan Bank of Pittsburgh**



Winthrop Watson  
President & Chief Executive Officer

**Federal Home Loan Bank of San Francisco**



Dean Schultz  
President and Chief Executive Officer

**Federal Home Loan Bank of Seattle**



Michael L. Wilson  
President and Chief Executive Officer

**Federal Home Loan Bank of Topeka**

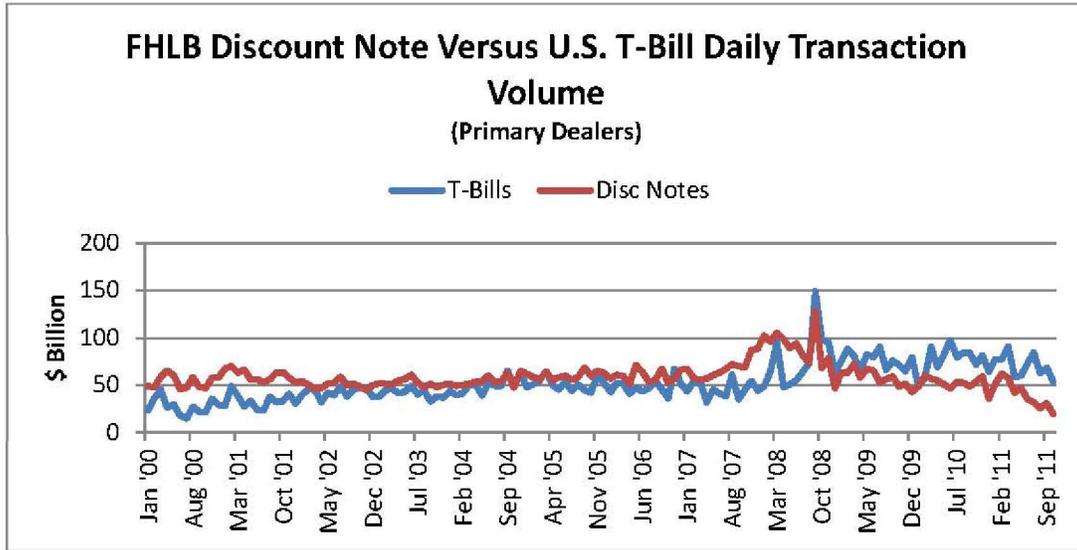


Andrew J. Jetter  
President and Chief Executive Officer

# EXHIBIT A

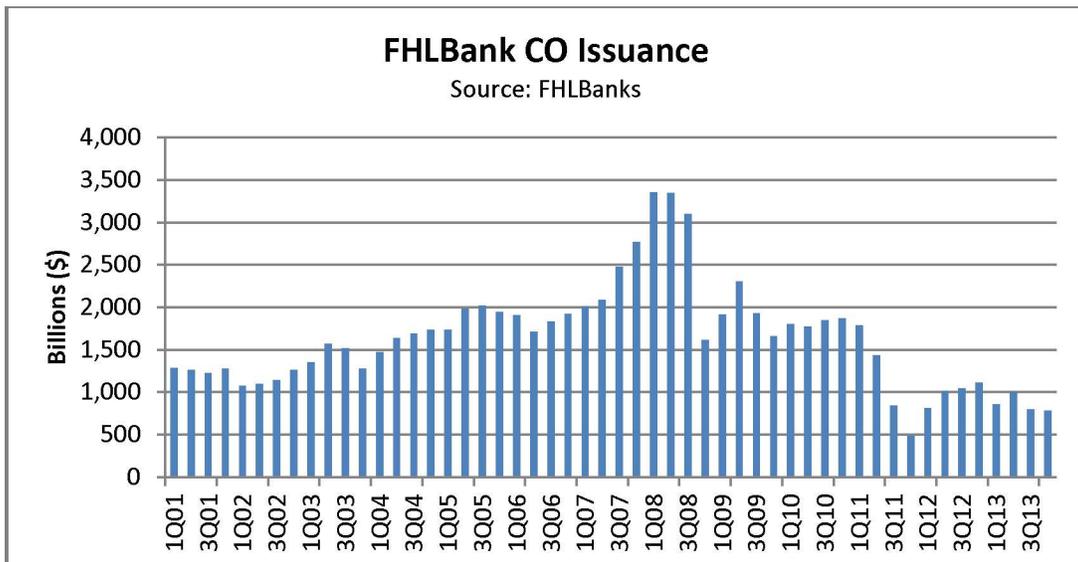
## Supporting Analytical Data

Chart 1



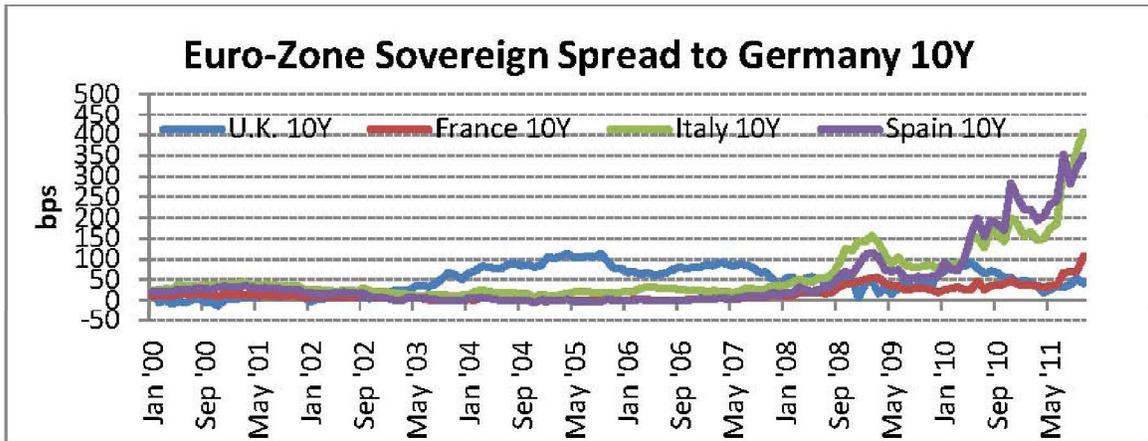
Source: Bloomberg

Chart 2



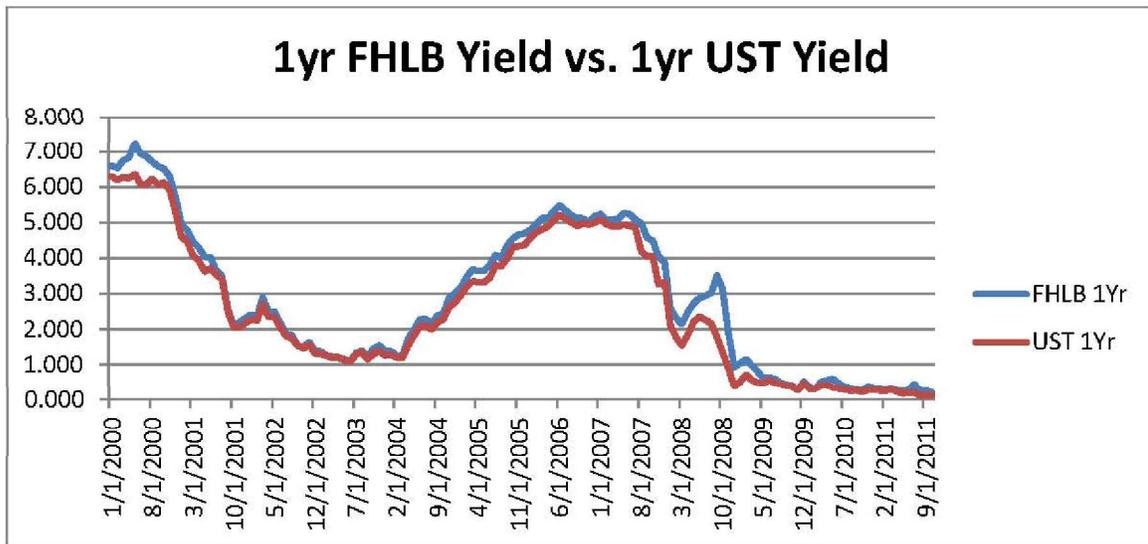
Source: FHLBanks

Chart 3



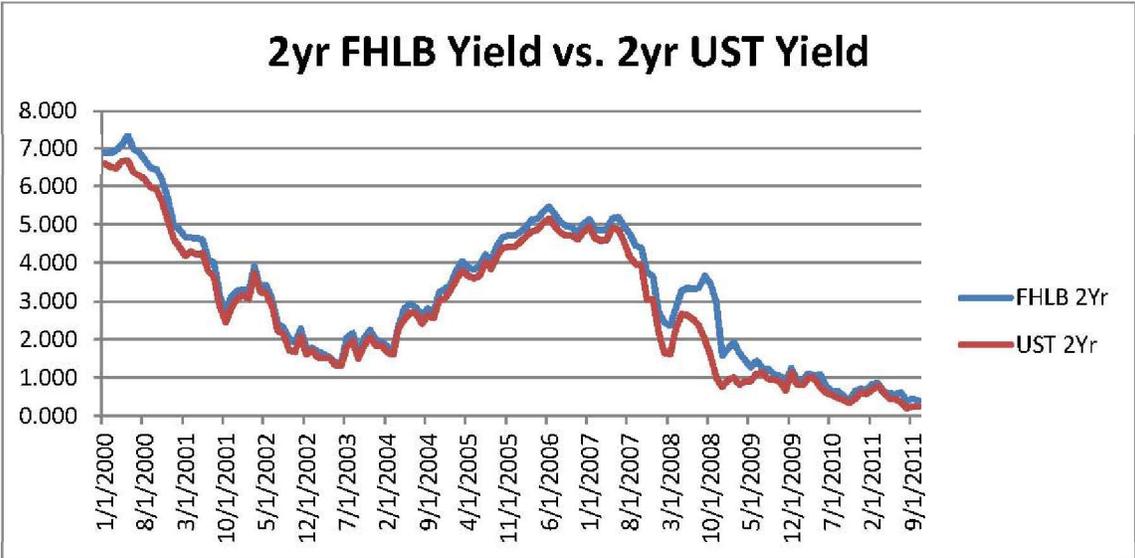
Source: Bloomberg

Chart 4



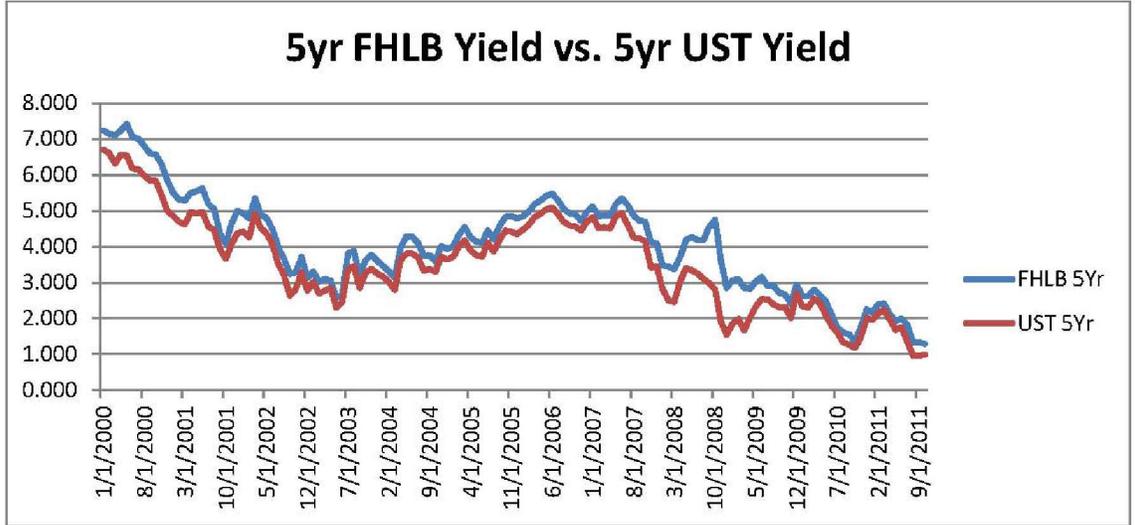
Source: FHLBanks

Chart 5



Source: FHLBanks

Chart 6



Source: FHLBanks