FHLBANKS
A NATION OF LOCAL LENDERS

August 29, 2022

Via Electronic Submission

Ms. Ann E. Misback
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551
E-mail: regs.comments@federalreserve.gov

Re: Regulation Implementing the Adjustable Interest Rate (LIBOR) Act, Docket No. R-1775, RIN 7100-AG34

Dear Ms. Misback:

On behalf of the eleven Federal Home Loan Banks (the "FHLBanks"), we appreciate this opportunity to comment on the Board of Governors of the Federal Reserve System's (the "Board" or "Federal Reserve") above-referenced proposed rulemaking ("Proposed Rule") implementing the Adjustable Interest Rate (LIBOR) Act (the "Act"). Unless otherwise defined in this letter, terms used herein shall have the meanings ascribed to them in the Proposed Rule.

Our comments include the following:

- FHLBank advances are distinguishable from contracts included in the definition of "covered GSE contracts" and, therefore, should be subject to a different Board-selected benchmark replacement;
- the Board-selected benchmark replacement for FHLBank advances should not be 30-day Average Secured Overnight Financing Rate ("SOFR"), which has generally been applied in-advance. Instead, the Board-selected benchmark replacement should be daily average SOFR determined in-arrears, a rate that more closely aligns with the cash flows and economic characteristics of newly issued FHLBank advances and amended legacy FHLBank advances, as well as related FHLBank funding, including the FHLBanks' $570

billion in SOFR-referencing floating rate notes issued to date, and the FHLBanks' asset and liability derivative hedging activities;

- as contemplated by the Act, the Board is expressly allowed to permit benchmark replacement conforming changes for the application of the Board-selected benchmark replacement, including to align such benchmark replacement with the reset and payment structure of the FHLBank advances with the Board-selected benchmark replacements' determination in-arrears at the end of a payment period, which is consistent with market practice for determinations and use of SOFR averages in-arrears;
- accordingly, conforming changes to the Board-selected benchmark replacement, including with respect to determination dates, reset dates, payment dates, calculation periods and adjustment spreads, should be expressly permitted to account for the use of a SOFR average calculated in-arrears rate as compared to the 30-day Average SOFR, which is generally applied in-advance;
- the rulemaking should clarify that there will be no negative inference with respect to FHLBank advances that have been amended prior to the London Interbank Reference Offered Rate ("LIBOR") replacement date to provide for fallback language that either: (i) specifies a non-LIBOR based rate, e.g., daily average SOFR in-arrears, or (ii) allows for the selection by an FHLBank of an unspecified non-LIBOR-based rate that is economically equivalent, e.g., daily average SOFR in-arrears; and
- the rulemaking should clarify the ambiguity that arises under the fallback provisions in certain non-covered contracts that specify that they are triggered only when LIBOR is unavailable stating explicitly that the trigger would occur when some form of LIBOR, e.g., so-called synthetic LIBOR, is available but non-representative.

I. The FHLBanks

The FHLBanks are government-sponsored enterprises ("GSEs") 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. The FHLBanks are regulated by the Federal Housing Finance Agency ("FHFA"), the safety and soundness regulator having primary jurisdiction over the FHLBanks.

The FHLBanks serve the general public interest by providing liquidity to approximately 7,000 member financial institutions, including banks, thrifts, credit unions, insurance companies, and community development financial institutions. In doing so, the FHLBanks help increase the availability of credit for residential mortgages, community investments, and other services for housing and community development. Specifically, all of the FHLBanks provide readily available, low-cost sources of funds to their member financial institutions through loans referred to as "advances." Some FHLBanks also purchase and hold residential mortgage loans from their member financial institutions.

II. The LIBOR Transition

On July 27, 2017, Andrew Bailey, then Chief Executive of the UK Financial Conduct Authority ("FCA"), announced that the FCA, which regulates the ICE Benchmark Administration,

the administrator of the LIBOR, would not compel panel banks to provide submissions for LIBOR after December 31, 2021.[1] On March 5, 2021, the FCA confirmed that non-US dollar LIBOR currencies would cease to exist or become non-representative on December 31, 2021, but extended the transition period for most of the US dollar LIBOR tenors until immediately after June 30, 2023.[2]

To provide for a legislative, nation-wide solution for so-called "tough" legacy instruments,[3] the US Congress adopted the Act, which was signed into law by President Biden on March 15, 2022. The Act provides that on the LIBOR replacement date, a benchmark replacement based on SOFR and selected by the Board, which includes a tenor spread adjustment as provided by the Act, will replace references to LIBOR in certain contracts that do not contain sufficient fallback language. On July 28, 2022, the Board published the Proposed Rule in the Federal Register.

The FHLBanks have acted and continue to act as leaders in respect of the LIBOR transition by prudently transitioning away from using LIBOR and toward the use of SOFR in connection with their lending, borrowing, derivatives, investment and other transactions. The FHLBank of New York represents the FHLBank system banks as a member of the Alternative Reference Rates Committee (the "ARRC")[4] and the FHLBanks have been active participants in working groups of trade associations, including the International Swaps and Derivatives Association ("ISDA"), who have developed solutions for the transition away from LIBOR. In addition, the FHLBanks have followed guidance from the FHFA issued in September of 2019. In accordance with such guidance, by December 31, 2019, the FHLBanks had stopped purchasing investments that reference LIBOR and mature after December 31, 2021 and, by June 30, 2020, had stopped entering into new loans, issuing debt, and entering into counterparty derivatives transactions that reference LIBOR and mature after December 31, 2021. The FHLBanks have also undertaken extensive efforts to amend legacy transactions that reference LIBOR to either (i) add non-LIBOR referencing fallback language that would be triggered upon LIBOR becoming unavailable or non-representative or (ii) replace LIBOR with an alternative reference rate, e.g., SOFR. Consistent with these efforts to successfully transition away from LIBOR and toward SOFR, the FHLBanks support the Act's and the Proposed Rule's goal of providing a uniform solution for transitioning to SOFR tough legacy instruments that reference LIBOR.

III. The Definition of "Covered GSE Contract"

The FHLBanks' primary comment relates to the Board's definition of "covered GSE contract" and the 30-day Average SOFR fallback rate that applies to such contracts. In particular, the FHLBanks believe that there are sufficient distinguishing elements between FHLBank

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[1] *See* Andrew Bailey, Chief Executive, FCA, The Future of LIBOR (July 27, 2017), https://www.fca.org.uk/news/speeches/the-future-of-libor.

[2] *See* FCA, FCA Announcement on Future Cessation and Loss of Representativeness of the LIBOR Benchmarks (Mar. 5, 2021), https://www.fca.org.uk/publication/documents/future-cessation-loss-representativeness-libor-benchmarks.pdf.

[3] Tough legacy transactions generally refer to transactions that use LIBOR as a reference rate and that either have no fallbacks in the event that LIBOR is no longer available or representative of rates in the sort of transactions that were used to determine LIBOR or that have rates determined by reference to a LIBOR rate or transactions based on LIBOR.

[4] The ARRC is a group of private-market participants convened by the Board and the New York Fed to help ensure a successful transition from USD LIBOR to a more robust reference rate, its recommended alternative, SOFR.

advances and the other types of instruments included in the definition of "covered GSE contracts" to warrant removal of FHLBank advances from the "covered GSE contract" definition.

FHLBank advances do not involve mortgages and, unlike securitized instruments,[5] FHLBank advances operates more like secured, commercial, bilateral, loans and do not involve multiple investors that may have varying consent rights. FHLBank advances also provide provisions that more easily allow their amendment by the relevant FHLBank and its member financial institutions, which are sophisticated financial institutions that are banks, thrifts, credit unions, insurance companies, and community development financial institutions. In addition, unlike the other product types included in the definition of "covered GSE contract," there are currently no outstanding FHLBank advances that reference 30-day Average SOFR calculated in advance of the interest accrual period.

Accordingly, the FHLBanks request that the Board not include FHLBank advances in the "covered GSE contract" definition and that such advances are subject to a different Board-selected benchmark replacement.

IV. A New Definition for "FHLBank Advances"

The 30-day Average SOFR fallback is not appropriate for FHLBank advances and does not reflect the rates that have or are expected to be utilized by the FHLBanks in transitioning away from LIBOR in their advances.

Once it became clear that LIBOR was going away, the FHLBanks have taken efforts to prepare for the transition, including, by some FHLBanks, through amendments of their outstanding portfolio of FHLBank advances to incorporate LIBOR fallback language that utilizes SOFR-based rates included in ARRC recommended fallback language for market participants for new originations of bilateral business loans referencing LIBOR. The 30-day Average SOFR rate proposed by the Board is calculated at the beginning of the period. In contrast, the FHLBanks advances have been using an average of SOFR calculated at the end of the period. Thus, using the Board's proposed rate would misalign cash flows for the Banks.

Furthermore, the Proposed Rule mentions that the Board selected 30-day Average SOFR as the appropriate fallback rate for covered GSE contracts because of the current use of such rate with respect to newly issued products, which would support the Board's goal of promoting "greater liquidity for legacy and newly issued covered GSE contracts."[6] However, newly issued FHLBank advances do not reference 30-day Average SOFR because such rate is operationally misaligned with existing FHLBank advance structures and, other than by the Board in the Proposed Rule, such rate has never been contemplated as a fallback for FHLBank advances. Since newly issued FHLBank advances do not use 30-day Average SOFR, the Board's argument regarding promoting liquidity by matching legacy fallback rates with rates used in newly issued instruments does not apply to FHLBank advances.

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[5] E.g., commercial or multifamily mortgage-backed securities, collateralized mortgage obligations or credit risk transfer transactions.

[6] Federal Reserve System, Regulation Implementing the Adjustable Interest Rate (LIBOR) Act, 87 Fed. Reg. 45,268.

FHLBank advances are funded through consolidated bonds and consolidated discount notes issued through the FHLBanks' agent, the Office of Finance. Newly issued and offered floating rate bonds reference various non-LIBOR based interest rates, including daily average SOFR in-arrears, which is the prevailing rate with respect to floating rate notes and bonds in the debt market. In order for FHLBank advances to match the terms of FHLBanks floating rate bonds, which serve as funding for the FHLBank advances, the appropriate fallback rate for legacy FHLBank advances should be daily average SOFR in-arrears as opposed to 30-day Average SOFR. To the extent that fixed-rate bonds are used to fund FHLBank advances, the FHLBanks may also enter into swap agreements to hedge their fixed-rate exposure through swaps that match the floating rate on their FHLBank advances. Legacy FHLBank swaps referencing LIBOR have incorporated the ISDA fallbacks for over-the-counter derivatives[7] and will fall back to compounded average SOFR in-arrears, a rate that is economically different from 30-day Average SOFR calculated in-advance. Accordingly, use of 30-day Average SOFR calculated in-advance in connection with FHLBank advances is misaligned with the rates and fallbacks used for funding and hedges and will result in unwanted risks to earnings spreads. As a result, the FHLBanks are requesting that the Board not select 30-day Average SOFR as the statutory benchmark replacement for FHLBank advances.

Accordingly, the FHLBanks believe that in order to align the cash flows and economic characteristics of existing FHLBank advances with FHLBanks funding through consolidated bonds and consolidated discount notes and related hedging activity, the Board should select daily average SOFR calculated in-arrears as the Board-selected replacement rate for such FHLBank advances.

V. Conforming Changes in respect of the Board-selected Benchmark Replacement

The FHLBanks request that the final rule expressly permit the FHLBanks to incorporate benchmark replacement conforming changes to implement the Board-selected benchmark replacement. In particular, the Board should expressly allow parties to make changes to determination dates, reset dates, payment dates, calculation periods and adjustment spreads, in order to allow the FHLBanks to better reflect the economics of replacing LIBOR with daily average SOFR in-arrears. This is particularly important because the FHLBanks anticipate replacing LIBOR, a forward-looking rate, with daily average SOFR in-arrears, which is an in-arrears rate. In addition, appropriate conforming changes to determination dates, reset dates, payment dates, calculation period and adjustment spreads are necessary to more closely align the economics and cash flows of legacy FHLBank advances with the economics and cash flows currently used by the FHLBanks in their advances and related hedging and funding activity. Accordingly, the FHLBanks request that the Board expressly permit the FHLBanks to make benchmark replacement conforming changes in respect of conventions for the use of the Board-selected benchmark replacement for FHLBank advances, including with respect to determination dates, reset dates, payment dates, calculation periods and adjustment spreads. If such an in-arrears rate with conforming changes is not specifically permitted as a Board-selected benchmark replacement, forward-looking CME Term SOFR would be a more appropriate Board-selected benchmark replacement for FHLBank advances. CME Term SOFR, which, like LIBOR, is a

[7] ISDA, ISDA 2020 IBOR Fallbacks Protocol, available at https://www.isda.org/protocol/isda-2020-ibor-fallbacks-protocol/

forward-looking rate, is the only economically aligned fallback if no such conforming changes are adopted.

VI. Statutory Protections in Section 105 of the Act

The Board has asked whether it should incorporate into the final rule the statutory protections in section 105 of the Act and whether the Board should make any clarifications related to these statutory protections. The FHLBanks advocate that the Board include these statutory protections, in particular those set forth in subsection (e) of section 105 of the Act, providing that, for non-covered contracts (i.e., contracts other than covered contracts subject to subsections (a), (b), or (c)(1) of section 104 of the Act):

> ". . . nothing in this [final rule] may be construed to create any negative inference or negative presumption regarding the validity or enforceability of (1) any benchmark replacement (including any method for calculating, determining, or implementing an adjustment to the benchmark replacement to account for any historical differences between LIBOR and the benchmark replacement) that is not a Board-selected benchmark replacement; or (2) any changes, alterations, or modifications to or with respect to a LIBOR contract that are not benchmark replacement conforming changes."

VII. Non-covered Contracts

The rulemaking should clarify the ambiguity that arises under the fallback provisions in certain non-covered contracts that specify that they are triggered only when LIBOR is unavailable without expressing that the trigger would occur when some form of LIBOR, e.g., so-called synthetic LIBOR, is available but non-representative. We agree that while the Act does not specifically address this issue, such a clarification of the ambiguity regarding the uniform application of triggers in fallbacks promotes the purpose of the Act to provide for an orderly transition away from LIBOR and the Board's clarification of such ambiguity would be reasonable for the reasons stated by the Board in the preamble to the Proposed Rule.

VIII. Conclusion

The FHLBanks request that the Board-selected benchmark replacement for FHLBank advances be in alignment with existing cash flow and economic valuation selections. The FHLBanks believe that 30-day Average SOFR as the benchmark replacement for FHLBank advances creates a mismatch between the cash flows and economic valuation of FHLBank advances and related funding and hedging activity. Accordingly, the FHLBanks request that the Board select daily average SOFR in-arrears to align with the existing fallback conventions of the FHLBanks' programs and expressly permit benchmark replacement conforming changes to implement such in-arrears rate.

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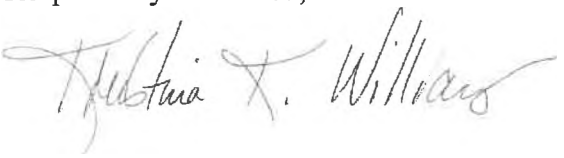
We appreciate the opportunity to comment. Please contact Philip Scott at (212) 441-6621 with any questions you might have.

Respectfully submitted,



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