

January 16, 2024

**Via Electronic Submission**

Chief Counsel's Office  
Attention: Comment Processing  
Office of the Comptroller of the Currency  
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Ann E. Misback  
Secretary  
Board of Governors of the Federal Reserve System  
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James P. Sheesley  
Assistant Executive Secretary  
Attention: Comments/Legal OES (RIN 3064-AF29)  
Federal Deposit Insurance Corporation  
550 17th Street NW  
Washington, DC 20429

**Re: Regulatory capital rule: Amendments applicable to large banking organizations and to banking organizations with significant trading activity (OCC: Docket ID OCC-2023-0008); (Federal Reserve: Docket No. R-1813, RIN 7100-AG64); (FDIC: RIN 3064-AF29)**

Ladies and Gentlemen:

On behalf of the Federal Home Loan Banks (the "FHLBanks") and the Federal Home Loan Banks Office of Finance (the "Office of Finance"), we appreciate this opportunity to comment on the above-referenced proposed rules (the "Proposed Rules") issued by the Office of the Comptroller of the Currency (the "OCC"), the Board of Governors of the Federal Reserve System (the "Federal Reserve"), and the Federal Deposit Insurance Corporation (the "FDIC" and, with the OCC and the Federal Reserve, the "Agencies"). The Proposed Rules address capital requirements applicable to large banking organizations and banking organizations with significant trading activity, and are proposed to be generally consistent with changes to international capital standards issued by the Basel Committee on Banking Supervision, known as Basel III.

Under the Agencies' existing capital requirements, debt securities issued by a government-sponsored enterprise ("GSE") are afforded a lower market price volatility haircut under the "collateral haircut approach" than higher risk non-GSE investment-grade securities. The collateral haircut approach is used to recognize credit risk mitigation benefits of collateralized repo-style transactions and margin loans. The Proposed Rules would adjust the market price volatility haircuts under the collateral haircut approach so that debt securities issued by a GSE would be afforded the same haircuts as non-GSE investment-grade securities (i.e., GSE securities would no longer receive the reduced haircuts). The FHLBanks, like other GSEs, are robustly regulated, and their debt obligations are highly liquid and present a low risk profile for investors. Moreover, such debt obligations are the means by which the FHLBanks are able to fulfill their statutory mission.

Accordingly, the FHLBanks and the Office of Finance respectfully request that the Agencies revise the collateral haircut approach under the Proposed Rules to continue to afford GSE securities lower market price volatility haircuts than those it affords to non-GSE investment grade securities consistent with their lower risk profile.

## **I. The FHLBanks**

The 11 FHLBanks are 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, through the Office of Finance (which is a joint office of the FHLBanks), issue debt securities (referred to as "**consolidated obligations**") for which each FHLBank is jointly and severally liable (i.e., if any FHLBank is unable to make its debt payment, each of the other 10 FHLBanks would be, individually and collectively, responsible for paying the debt in full). Congress established the FHLBanks to provide liquidity to their approximately 6,500 member institutions to increase the availability of credit for residential mortgages, community investments, and other services for housing and community development. Specifically, the FHLBanks are a stable, dependable, and low-cost source of funds for their member institutions, which members play a critical role in housing affordability, community development, and market stability.

To effectively provide services to their members and satisfy their statutory mandate, the FHLBanks rely on the funds raised by the debt obligations they issue. The FHLBanks are robustly regulated by the Federal Housing Finance Agency ("**FHFA**"), resulting in a uniquely low risk profile for investors who purchase FHLBank debt obligations. This allows the FHLBanks to obtain financing on favorable terms to meet their objectives. The continued demand for FHLBank debt, and the liquidity of the market for FHLBank debt, is essential for the FHLBanks to continue to perform their statutory mandate of providing readily available, low-cost sources of funds to FHLBank members, allowing such members to provide favorably priced loans to their customers for purposes of housing and community development throughout the United States.

## **II. Treatment of FHLBank Debt Securities in Collateralized Transactions for Purposes of Credit Risk Exposure under Capital Requirements**

Under the current capital requirements related to credit risk, large banks and banking organizations with significant trading activity may recognize the risk-mitigation benefits of repurchase and reverse repurchase ("**repo-style**") and certain other collateralized transactions by taking into account the value of the collateral posted to them in such transactions via the use of the collateral haircut approach. The collateral haircut approach allows banking organizations to reduce their credit exposure for a collateralized transaction by the value of the collateral they receive from counterparties, adjusted through a formula that includes standard supervisory price volatility haircuts, to account for market price volatility in the value of the collateral. The market price volatility haircut applied to the value of any collateral is determined by a chart that varies based on asset type, residual maturity, and the risk weight of the issuer.

The FHLBanks are concerned that certain changes in the Proposed Rules related to credit risk mitigation may negatively affect demand for and pricing of the debt obligations the FHLBanks issue. The Proposed Rules, among other changes to the credit risk mitigation framework for collateralized transactions and to capital requirements generally, would amend the market price volatility haircuts to (1) vary with a greater number and range of haircuts for the residual maturities of the collateral and (2) remove the variation in the haircuts with respect to the underlying risk weight of the issuer, except for sovereign issuers. Based on the Proposed Rules' second change to market price volatility haircuts, for the purposes of calculating bank credit risk exposure in collateralized transactions, the value assigned to FHLBank debt offered as collateral would be, in some cases, substantially reduced. These changes may affect demand for FHLBank debt securities and, as a result, the FHLBanks may not be able to provide credit to their member institutions as consistently and on as favorable terms as they do today. For the reasons discussed below, the Proposed Rules' removal of variation in the market price volatility haircuts by risk

weight of non-sovereign issuers should be amended to better align with the risk profile of collateral issued by low-risk non-sovereign issuers, including by the FHLBanks and other GSEs. Specifically, the collateral haircut approach should be revised so that the haircuts vary by the risk weights assigned to non-sovereign issuers, as is the case for purposes of computing credit risk with respect to debt investments under the Proposed Rules.

A. *Debt Obligations of the FHLBanks Have a Uniquely Low Risk Profile*

A number of factors contribute to the resiliency and stability of the market for FHLBank debt obligations. First, each FHLBank bank is jointly and severally liable for FHLBank debt obligations. Second, the FHLBanks are robustly regulated by the FHFA, which helps ensure the stability of the FHLBanks through various regulatory obligations, including capital requirements, imposed on the FHLBanks. Third, because of the FHLBanks' GSE status, the credit ratings of the FHLBank System and the FHLBanks have traditionally been linked to the sovereign credit of the U.S., and those have historically moved in tandem and commensurately.<sup>1</sup> Investors purchase FHLBank debt obligations in part because of the stability and resiliency of FHLBank debt that results from these factors, and some use FHLBank debt securities in repo-style collateralized transactions with banking organizations, which contributes to the very liquid secondary market for FHLBank debt securities.

Many federal regulations recognize the low risk of FHLBank debt obligations by providing preferential treatment to FHLBank debt. For example, FHLBank debt obligations, as GSE debt exposures, are afforded a 20% risk weight for the purpose of computing credit risk with respect to debt investments under the Proposed Rules (which do not change the existing approach). FHLBank debt similarly receives preferential treatment for investment eligibility requirements for national banks pursuant to 12 C.F.R. § 1.2(j)(5). This lower risk profile is also reflected in the recognition of FHLBank debt securities as government securities, which forms the basis for the SEC's exemption for FHLBank debt securities from certain registration and disclosure requirements pursuant to Section 3(a)(12) of the Securities Exchange Act of 1934.

Notwithstanding these considerations, the Proposed Rules would remove preferential treatment for FHLBank debt with regard to collateralized transactions by eliminating the variation of price volatility haircuts by risk weight of non-sovereign issuers. In the Proposed Rules, the Agencies state that issuer risk weight was removed as a basis for the haircuts to non-sovereign debt securities because they "figure[] less prominently in the instrument's market price volatility," derived "from observed stress volatilities during 10-business day periods during the 2008 financial crisis." 88 Fed. Reg. 64028, 64062-64063. However, based on the liquidity of the market for FHLBank debt obligations, as well as the resiliency of that market due to regulatory oversight, we believe that FHLBank debt securities typically have lower market price volatility than many other debt exposures (such as less creditworthy and less liquid corporate and sovereign debt). In fact, during the early periods of the 2008 financial crisis, before the Federal Reserve created new liquidity facilities, the FHLBanks served as a vital source of liquidity for their member institutions, managed through the largely uninterrupted issuance of FHLBank debt obligations during this period.<sup>2</sup> The Agencies themselves have acknowledged this. In the proposing release for the Proposed Rules, the Agencies stated that "GSE debt instruments guaranteed by the GSEs consistently trade in very large volumes and, similar to U.S. Treasury securities, have historically been able to rapidly generate liquidity for a banking organization, including during periods of severe market stress." 88 Fed. Reg. 64028, 64139. Moreover, the Agencies' existing capital requirements afford GSE debt a 20% risk weight for the purpose of computing credit risk, whereas

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<sup>1</sup> Currently, the FHLBanks have an issuer credit rating of Aaa/P-1 by Moody's Investors Service ("**Moody's**") and AA+/A-1+ by S&P Global Ratings ("**S&P**"). The consolidated obligations of the FHLBanks also carry credit ratings of Aaa/P-1 by Moody's and AA+/A-1+ by S&P.

<sup>2</sup> See Natalie Leonard, *United States: Federal Home Loan Bank Advances, 2007–2009*, 4 J. Financial Crises 1201 (2022) (describing how FHLBank advances "grew by approximately \$360 billion between year-end 2006 and mid-2008," providing "broad support to the financial system" during this period); see also Federal Home Loan Banks Office of Finance, *Federal Home Loan Bank 2008 Annual Combined Financial Report*, at 48, 182, 231-35 (2009) (showing the increase of advances by the FHLBanks during this period, and the increase of the issuance of consolidated obligations to fund the advances).

non-GSE corporate debt is afforded a 65% to 100% risk weight; this would not change under the Proposed Rules.

The Proposed Rules purport to amend the bases for market price volatility haircuts under the collateral haircut approach to make the haircuts more risk-sensitive. To align with this stated goal, the Proposed Rules should reflect the lower market price volatility associated with FHLBank debt securities as compared to other debt securities by assigning GSE debt securities lower market price volatility haircuts than those that would apply to non-GSE debt securities.

*B. The Proposed Rules' Approach to Market Price Volatility Haircuts is Inconsistent Between Sovereign and Non-Sovereign Issuers*

While the Proposed Rules would eliminate risk weight of non-sovereign issuers as a basis for varying market price volatility haircuts, they would retain risk weight as a basis for sovereign issuers of debt securities. Thus, the Agencies must believe that, at least for sovereign issuers, the factors contributing to a lower issuer risk weight correlate to some degree with the market price volatility of an issuer's debt instruments. If the Proposed Rules are meant to increase risk sensitivity regarding the price volatility haircuts applied to collateral, the same factors involved in the analysis for sovereign issuers should apply with respect to non-sovereign issuers.

As described above, FHLBank debt and corporate debt are rated by credit rating agencies, as are U.S. Treasury securities and other sovereigns' debt. The different credit ratings of these debt securities, like the different risk weights of the debt securities' issuer, are based on a number of factors related to the creditworthiness of the relevant issuer and the likelihood that the debt obligations of the securities will be fulfilled. For example, due to the guarantee of payment obligations for U.S. Treasury securities ("**Treasuries**") and the resiliency and liquidity in the Treasuries market, the issuer of Treasuries, i.e., the United States government, is assigned a lower risk weight compared to other, more risk-laden sovereign exposures. For the same reasons, Treasuries are less susceptible to market price volatility than more risk-laden sovereign exposures. To reflect this difference in price volatility, the haircuts applied to Treasuries offered as collateral are lower than instruments issued by sovereign issuers with a higher risk weight.

The same logic should apply for non-sovereign debt instruments. When compared to other investment-grade securities, FHLBank debt has a lower risk profile and high credit ratings (which have historically been aligned with the sovereign credit ratings of the United States). We believe that this is in part based on the status of the FHLBanks as robustly regulated GSEs, the FHLBanks' joint and several liability on debt obligations they issue, and the highly liquid secondary market for FHLBank debt obligations. These factors justify the application of market volatility haircuts that are lower than those for less creditworthy and less liquid corporate and sovereign debt. The current capital requirements regarding the risk mitigation treatment of collateralized transactions recognize this logic, and provide similar treatment for both sovereign and non-sovereign debt securities. The Proposed Rules would remove this treatment without sufficient explanation and would ultimately result in a less risk-sensitive approach to the risk mitigation benefits afforded under the existing capital requirements to which banking organizations are subject.

*C. The Potential Harm of the Proposed Rules' Change Outweighs Any Potential Benefit*

The dual statutory mandates of the FHLBanks are to provide liquidity to their members to support housing finance and community development through all economic cycles and support affordable housing. The FHLBanks fulfill their liquidity mission by providing billions of dollars of advances (loans) to their roughly 6,500 members each year. The liquidity provided by the FHLBanks helps their members meet the lending needs of communities throughout America and maintain adequate balance sheet management. The FHLBanks have fulfilled their liquidity mission successfully for over 90 years. Insofar as affordable housing is concerned, on an annual basis, each FHLBank must set aside at least 10 percent of its prior year's income to fund its Affordable Housing Program ("**AHP**"). Collectively, the FHLBanks must meet an annual minimum allocation of \$100 million toward AHP funding. From 1990, the AHP's first year, through 2022, the FHLBanks

collectively awarded over \$7.6 billion in AHP grants, helping more than one million households purchase or preserve a home.

FHLBank debt obligations are the principal source of funding for the FHLBanks that enables them to achieve their dual statutory mandates. The Proposed Rules' removal of preferential treatment for FHLBank debt obligations in comparison to investment-grade corporate debt under the collateral haircut approach could serve to disincentivize the use of FHLBank debt obligations as collateral repo-style transactions and margin loans. This may harm liquidity for FHLBank debt obligations in the market, impact general demand for FHLBank debt obligations, and increase the FHLBanks' cost of funding due to potential higher interest rates as a result of the foregoing. Ultimately, this would undermine the ability of the FHLBanks to satisfy their statutory mandate to provide reliable and consistent credit for the purposes of affordable housing and community development. We believe that the likely harm to the FHLBanks' vital purpose of providing reliable and consistent credit to their member institutions outweighs any potential benefit from the increase in haircuts to FHLBank debt obligations held as collateral by banking organizations to reduce their credit exposure for affected transactions.

### III. Conclusion

Based on the foregoing, the FHLBanks and the Office of Finance respectfully request that the Agencies revise the collateral haircut approach under the Proposed Rules to continue to afford GSE securities, including FHLBank debt securities, lower market price volatility haircuts in accordance with their lower risk profile than haircuts it affords to non-GSE investment grade securities.

We appreciate the opportunity to provide these comments on the Proposed Rules. Please do not hesitate to contact Ray Ramirez (202.383.0868 or [RayRamirez@eversheds-sutherland.com](mailto:RayRamirez@eversheds-sutherland.com)) or John Coffron (202.383.0321 or [JohnCoffron@eversheds-sutherland.com](mailto:JohnCoffron@eversheds-sutherland.com)) with any questions or to discuss this comment letter.

Respectfully submitted,

**Eversheds Sutherland (US) LLP**

BY:  \_\_\_\_\_

Raymond A. Ramirez

**FOR THE FHLBANKS AND THE OFFICE OF FINANCE**

cc: FHLBank Presidents & Office of Finance Chief Executive Officer  
FHLBank & Office of Finance General Counsel