COUNCIL OF FEDERAL HOME LOAN BANKS, RYAN DONOVAN

Proposal and Comment Information

Title: Request for Information and Comment on Operational Aspects of Federal Reserve Bank Extensions of Discount Window and Intraday Credit, OP-1838

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Submitter Information

Organization Name: Council of Federal Home Loan Banks

Organization Type: Organization

Name: Ryan Donovan

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Please find attached comments from the Council of Federal Home Loan Banks, on behalf of the 11 Federal Home Loan Banks.

FHLBANKS
A NATION OF LOCAL LENDERS

December 9, 2024

Ann E. Misback
Secretary, Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington, DC 20551

Re: Request for Information and Comment on Operational Aspects of Federal Reserve Bank Extensions of Discount Window and Intraday Credit

Dear Ms. Misback:

The Council of Federal Home Loan Banks (Council), a trade association that represents the views and positions of the 11 Federal Home Loan Banks (FHLBanks), respectfully submits this comment letter in response to the request for information and comment (RFI) issued by the Board of Governors of the Federal Reserve System (Federal Reserve) in September 2024 seeking input about operational practices of the discount window.[1] Thank you in advance for considering our views.

Introduction

FHLBanks, established by Congress in 1932, are member owned-financial cooperatives that serve approximately 6,500 members, including banks, credit unions, insurance companies, and community development financial institutions.[2] The mission of the FHLBanks is to provide reliable on-demand liquidity and longer-term funding to support housing finance and community investment. We therefore appreciate the opportunity to respond to the RFI given the FHLBanks' vested interest in ensuring that their members have ready access to multiple sources of liquidity, including through the Federal Reserve's discount window.

The FHLBanks play an essential role in the financial system as reliable liquidity providers, a mission that complements the liquidity function and lender of last resort role of Federal Reserve Banks. In this context, any changes to the discount window should carefully preserve this statutory mission of the FHLBanks. Modifications should not unintentionally crowd out or duplicate the liquidity provision intended by Congress to be provided by the FHLBanks. The complementary relationship between FHLBanks and Federal Reserve Banks has generally worked well over the years with individual FHLBanks and Federal Reserve Banks collaborating on collateral-related matters of their common member institutions on an as-needed basis. At the same time, the events of March 2023

[1] Federal Reserve, *Request for Information and Comment on Operational Aspects of Federal Reserve Bank Extensions of Discount Window and Intraday Credit*, 89 Fed. Reg. 73415 (Sep. 10, 2024).
[2] This comment letter focuses on FHLBank members who also have access to the discount window, such as banks and credit unions.

1800 M Street, NW, Suite 400S
Washington, DC 20036

www.fhlbanks.com
202-955-0002

highlighted opportunities to further strengthen this relationship and improve our members' access to the discount window. For instance, it became clear that some members were not ready to borrow from the discount window and had not tested their discount window lines. Also, some members experienced acute liquidity needs outside normal business hours. These events collectively underscored the importance of quickly creating borrowing capacity for FHLBank members at Federal Reserve Banks, particularly those members in financial distress.

Based on these recent experiences, this comment letter identifies the challenges our members may face when borrowing from the discount window and offers our recommendations for how FHLBanks and Federal Reserve Banks can work together to facilitate increased access to this critical liquidity resource, all while preserving the FHLBanks' statutory liquidity role. These recommendations include ideas for creative solutions that could obviate the need to rapidly transfer collateral to Federal Reserve Banks in stressed scenarios.

Challenges to Discount Window Usage and Access

Competing Security Interests

One challenge for our members borrowing from the discount window arises from FHLBanks and Federal Reserve Banks having competing security interests to the same collateral. When FHLBanks make advances (or loans) to their members, such advances are required to be fully secured by member collateral.[3] Each FHLBank will perfect its security interest in pledged collateral typically by filing a UCC-1 financing statement in the appropriate jurisdiction.[4] Federal Reserve Banks, likewise, may also have a security interest in the same collateral. Similar to FHLBanks, Federal Reserve Banks are required to have a perfected security interest in collateral pledged as security for discount window borrowings and will typically file UCC-1 financing statements to perfect their security interest.

These competing claims can impact a FHLBank member when it requires emergency funding from the discount window and needs its FHLBank to quickly release or subordinate excess collateral to a Federal Reserve Bank. The FHLBank and Federal Reserve Bank need to have in place satisfactory intercreditor arrangements to facilitate the handling of such collateral. Each FHLBank has worked with its respective Federal Reserve Banks to establish documentation and procedures to release or subordinate certain categories of excess collateral. However, to date, there has not been a uniform process for handling the release or subordination of excess collateral between FHLBanks and Federal Reserve Banks on an expedited basis. The March 2023 events underscored the benefits of closer coordination between FHLBanks and Federal Reserve Banks on their respective collateral positions, which can improve our members' access to the discount window and enable quicker access to funding.

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[3] Laws and regulations governing FHLBanks require FHLBanks to have a perfectible security interest in such collateral. *See*, e.g., 12 U.S.C. §1430(a) (requiring each FHLBank to make secured advances upon collateral sufficient to fully secure such advances); and 12 C.F.R. Part 1266.2(c)(3). FHLBank-eligible collateral includes, among others, residential mortgages, commercial mortgages, agency securities, cash, and other real estate collateral.

[4] FHLBanks may also perfect their security interests in other ways permitted by the applicable Uniform Commercial Code, including by requiring members to deliver certain collateral to the FHLBank or a third-party custodian.

Time Required to Establish Pledging Capacity

Our members may experience operational frictions establishing pledging capacity at Federal Reserve Banks with respect to their FHLBank-eligible loan collateral. It is our experience that some Federal Reserve Banks may not possess as much residential and commercial loan collateral details as some FHLBanks. If a member requests its FHLBank to release or subordinate specific loan collateral to a Federal Reserve Bank, the process to set up new loan collateral types at a Federal Reserve Bank can be time-consuming. This process can delay our members' access to the Federal Reserve Bank's discount window.

Uneven Information Sharing Arrangements with Federal Reserve Banks

We note that not all FHLBanks receive the same level of credit and discount window-related information from Federal Reserve Banks, including information about FHLBank members in stressed conditions. Although Federal Reserve Banks are not required to disclose discount window borrowings to FHLBanks, improving communication and transparency can strengthen the ability of the FHLBanks to manage and release or subordinate collateral quickly, ensuring members have timely access to necessary funding.

Suggestions for Efficiencies

Establish Uniform Emergency Intercreditor Agreement and Collateral Management Practices

There are efforts currently underway to develop a standard agreement that FHLBanks can use to facilitate the release or subordination of excess collateral to Federal Reserve Banks in emergency situations. We are supportive of these efforts and look forward to further engaging with Federal Reserve Banks in developing this standard agreement.

Additionally, to make the intercreditor process and agreement more effective, FHLBanks and Federal Reserve Banks could also consider entering into bilateral collateral management arrangements setting forth the respective rights and obligations of the parties with respect to loan collateral pledged to both parties. Under the arrangements, FHLBanks and Federal Reserve Banks could agree to exchange information regarding their respective collateral positions for common member institutions on a periodic basis. The agreement could outline how the parties will treat any 'double-pledged' collateral, including establishing clear rules for determining which entity has priority over the other with respect to any such collateral. Moreover, the agreement could incorporate uniform or standardized collateral listing templates, which would help ensure important loan information is retained and easily accessible. Increasing information sharing on a more detailed and periodic basis could make the subordination or collateral release process easier and quicker, as both parties would have insight into the specific collateral pledged to each lender.

Enhancing Information Sharing Arrangements

Enhanced information sharing agreements between FHLBanks and Federal Reserve Banks would help facilitate the sharing of critical member-related information, which would promote greater transparency about our members' respective borrowing activity. These agreements may also cover the exchange of information when Federal Reserve Banks act as primary regulator of a FHLBank member.[5] Having such an agreement could foster 'early warning' conversations with FHLBanks about members under financial stress. FHLBanks could use this information to encourage their members to make sure they are fully prepared to borrow from their Federal Reserve Bank and to help FHLBanks be ready to subordinate or release excess collateral should the need arise.

Moreover, the FHLBanks' primary federal regulator, Federal Housing Finance Agency (FHFA), recently issued Advisory Bulletin 2024-03 (FHLBank Member Credit Risk Management), which requires FHLBanks to establish key elements in the oversight of troubled members, including escalation policies and procedures, coordination with members' prudential regulators, and default or insolvency management policies and procedures.[6] Pursuant to that advisory bulletin, information sharing among the FHLBanks and respective Federal Reserve Banks would enhance those processes.

Creative Collateral Solutions

Our decades-long expertise in managing and valuing a variety of collateral types, including residential and commercial loan collateral, could be leveraged to find creative solutions and avoid duplicative work for quickly moving collateral capacity from FHLBanks to Federal Reserve Banks. One potential solution could include FHLBanks serving as collateral agent for Federal Reserve Banks, where Federal Reserve Banks would rely on FHLBank collateral management and valuation practices to assign borrowing capacity to a particular member. In this scenario, FHLBanks would hold "FHLBank Collateral" for the benefit of Federal Reserve Banks in a custodial capacity without actually transferring collateral to a Federal Reserve Bank. Another potential solution could include FHLBanks issuing a letter of credit on behalf of a FHLBank member to a Federal Reserve Bank as the beneficiary. The letter of credit would serve as collateral to support member borrowing from the Federal Reserve Bank. Like the collateral agent option discussed above, the letter of credit arrangement would not require any securities or loan collateral to be transferred to the Federal Reserve Bank.

Conclusion

We believe the suggestions offered in this comment letter will enhance the liquidity missions of both FHLBanks and Federal Reserve Banks and promote stability in the financial system. We note that the FHFA has also encouraged FHLBanks to enhance their coordination with Federal Reserve Banks to ensure our members have access to the discount window. This comment letter is part of our efforts

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[5] Information sharing agreements also would operationalize statutory information sharing requirements set forth in 12 U.S.C. § 1442 providing that primary regulators share reports, records, and other information pertaining to the condition of FHLBank members with FHLBanks.

[6] *See* Federal Housing Finance Agency, Advisory Bulletin, AB 2024-03: FHLBank Member Credit Risk Management, at 9 (Sep. 27, 2024).

to that end. FHLBanks stand ready to continue working with Federal Reserve Banks, and we welcome the opportunity to discuss the matters contained in this comment letter.[7]

Sincerely,

Ryan Donovan
President and CEO

[7] We also invite Federal Reserve Banks to participate in any public FHFA rulemaking or guidance process regarding matters contained in this comment letter, including the FHFA's planned rulemaking or guidance related to FHLBank collateral subordination practices, which is scheduled to be issued by June 30, 2025. *See* Federal Housing Finance Agency, Office of Inspector General. (2024). *FHFA Could Enhance Its Supervision of the Federal Home Loan Banks by Incorporating Lessons Learned from the Spring 2023 Bank Failures*, p. 23. This rulemaking or guidance could be an opportunity for Federal Reserve Banks to provide feedback in a public forum about ways FHLBanks could further enhance their subordination practices in connection with FHLBank members' discount window borrowings.