July 6, 2010

By e-mail to *RegComments@FHFA.gov*

Alfred M. Pollard, General Counsel
Attention: Comments/RIN 2590-AA32
Federal Housing Finance Agency
Fourth Floor
1700 G Street, NW
Washington, DC 20552

Re: Comments on Notice of Proposed Rulemaking for Federal Home Loan Bank Investments (RIN 2590-AA32)

Dear Mr. Pollard:

On behalf of the Federal Home Loan Bank of Topeka, we appreciate the opportunity to comment on the Federal Housing Finance Agency (FHFA) notice of proposed rulemaking (NPR) that would re-organize and re-adopt existing investment regulations for the Federal Home Loan Banks (collectively the Banks or individually a Bank) that were previously adopted by the Federal Housing Finance Board (FHFB). The FHFA is also proposing to incorporate into the new regulation limits on a Bank's investment in mortgage-backed securities (MBS) and certain asset-backed securities. These limits are currently set forth in the FHFB's Financial Management Policy.

Our comment letter first addresses the specific requests in the NPR and then presents a much broader proposal for the FHFA's consideration.

Quantitative and Other Limitations on MBS
We support limits on the amount of MBS a Bank is allowed to purchase. Clearly the risks involved in investing in MBS are significantly greater than the risks associated with the advances business. It is only prudent that the amount of MBS a Bank is allowed to purchase be limited from a safety and soundness standpoint and to ensure the advances business remains the primary activity of every Bank. The current rules limit MBS based on the amount of capital held by the Bank. Given the characteristics of a Bank's capital stock, we believe it would be preferable to base an MBS limit on the amount of retained earnings held by a Bank, not a Bank's total capital. While capital stock qualifies as capital, its ability to absorb losses is qualitatively different than that of retained earnings. In addition, given that private label MBS (PLMBS) involves a significantly greater level of credit risk than does Agency MBS, the applicable limit for PLMBS should be lower than the limit applied to total MBS.

Characteristics and Restrictions on Collateral of PLMBS Purchases
On April 12, 2007 the Office of Supervision issued Advisory Bulletin 2007-AB-01, which established expectations for the Banks' pre-purchase analysis and periodic reviews of MBS investments. Subsequently, on July 1, 2008, the Office of Supervision issued Advisory Bulletin 2008-AB-02 that expressed the expectation that the Banks' purchases of PLMBS will be limited to securities in which the underlying mortgage loans comply with all aspects of the federal banking agencies' *Interagency Guidance on Nontraditional Mortgage Product Risks*[1] and *Statement on Subprime Mortgage Lending*[2]. We are in agreement with the FHFA's proposal that the principles outlined in the interagency guidance and the 2007 Advisory Bulletin be incorporated into the final rule in keeping with the objective of reorganizing existing guidance that is dispersed over several sources. However, the standards enumerated in these Advisory Bulletins (i.e., representations and warranties) should not be applied retroactively to PLMBS purchases. The mortgage originator should not be held to a retroactive standard through the request to make representations and warranties as to the kinds of mortgages that were placed in the mortgage security when such legal requirements were not in place at the time the security was created.

[1] Issued on October 4, 2006 (71 FR 58609)
[2] Issued on July 10, 2007 (72 FR 27569)

Investment Grade Ratings for PLMBS

We support a requirement that all PLMBS purchased by a Bank be limited to securities with the highest investment grade rating at the time of purchase by a Bank in an effort to limit the potential risks to the Banks from their MBS portfolios. As a practical matter, the Banks have operated in compliance with this standard by limiting their PLMBS purchases to the highest investment grade rating. Therefore, we are supportive of its incorporation into the final rule. As is currently the case, a Bank should not be required to divest a PLMBS if the investment rating of the PLMBS falls subsequent to its purchase by a Bank.

Back to a Safe and Secure Future

Finally, we believe the NPR is an opportunity to step back and look at the future of the Bank System and the role of MBS in that future. As Director DeMarco has noted, the ability to invest in MBS was given regulatory approval in order to meet the burdens imposed by REFCorp and the Affordable Housing Program (AHP). This expanded investment authority was preceded by the confiscation of the legal reserves held by the Banks. In its effort to address the savings and loan crisis, Congress over the course of a few years seized the legal reserves of the Banks and at the same time imposed significant obligations to fund REFCorp and AHP going forward. With the benefit of hindsight, we can see that reducing capital and expanding risk to address earnings pressures creates the potential for significantly negative outcomes.

As the Banks draw closer to fulfilling the REFCorp obligation, we believe this is the time to return to the prudent practices of the past. There is no question that the Banks were put at greater risk when their required reserves were confiscated and the AHP and REFCorp obligations were imposed. An adequate capital cushion for the Banks is fundamental to safe and sound operations, protecting taxpayers and preserving the benefits of the Bank System. In the past, the Banks took aggressive steps to meet the obligations that were placed on them. As we now look forward to completing the REFCorp obligation, we need to revert to the practices that made the Banks strong in the past.

When the REFCorp obligation ends, we propose that the FHFA mandate each Bank contribute the cash flows that but for the satisfaction of the REFCorp obligation would previously have gone towards the REFCorp obligation (i.e., 20 percent of net income after AHP) to a new retained earnings reserve. The required retained earnings reserve would build until it reaches 4 percent of assets, with the result that each Bank would eventually hold 8 percent of assets in capital (4 percent in required retained earnings reserves and 4 percent in member capital stock and non-required retained earnings). As total reserves are built, the authority of the Banks to invest in MBS could be reduced. Below is a possible schedule for gradually reducing MBS authority as reserves build.

Required RE Reserve as Percentage of Assets	*Maximum MBS Purchase Authority*
Less than 0.5 Percent	3.0 Times Capital
.5 to 1 Percent	2.5 Times Capital
1 to 1.5 Percent	2.0 Times Capital
1.5 to 2 Percent	1.5 Times Capital
2 to 3 Percent	1.0 Times Capital
3 to 4 Percent	0.5 Times Capital
Over 4 Percent	No authority to purchase MBS

This proposed phased reduction in MBS authority will allow the Banks to gradually reduce their reliance on MBS while building capital and retained earnings to levels that will protect taxpayers and ensure the long-term financial health of the Bank System.

We acknowledge that this proposal continues to base MBS authority on total capital rather than retained earnings as discussed earlier. To the extent that the intent is to phase out MBS, we believe it would be preferable to utilize the current metric for MBS limits rather than developing new limits using different metrics.

We also note that Congress and the Obama Administration are currently developing proposals for the future of residential housing finance in the United States. To the extent that Congress determines the Banks have a role in supporting the MBS and PLMBS markets, the need for additional retained earnings at the Banks will be even stronger. Retaining post-REFCorp cash flows for retained earnings reserves will be even more important. We urge the FHFA to initiate regulatory action to ensure that post-REFCorp cash flows are used to build retained earnings.

We thank the FHFA for its consideration of these comments.

Sincerely,

Ronald K. Wente
Chairman

Andrew J. Jetter
President and CEO