



July 6, 2010

*via Federal eRulemaking Portal and  
electronic 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:

The Federal Home Loan Bank of Boston (“Bank”) appreciates this 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 (“FHLBanks”) that were previously adopted by the Federal Housing Finance Board (“FHFBoard”). The FHFA is also proposing to incorporate into the new regulation limits on FHLBanks’ investment in mortgage-backed securities (“MBS”) and certain asset-backed securities. These limits are currently set forth in the FHFBoard’s Financial Management Policy (“FMP”).

The FHFA is seeking comments on whether it should adopt additional restrictions, or lower the overall limit, on the FHLBanks’ investment in MBS generally, and particularly in private-label MBS (“PLMBS”). The FHFA has posed four questions to the FHLBanks pertaining to this issue. We respectfully address each of these questions below for the FHFA’s consideration.

We note as a general matter that we view the FHLBanks’ ability to invest in MBS (and particularly Agency MBS) as important to providing liquidity to that market, and as a mission-consistent, counter-cyclical and stabilizing influence on FHLB earnings, particularly when advances demand slows and in light of the current Resolution Funding Corporation (“REFCO”) and Affordable Housing Program (“AHP”) obligations. The FHFA has recognized this in the past as well, both in terms of broadening the FHLBanks’ authority to invest in MBS following the passage of the Financial Institutions Reform, Recovery, and Enforcement Act, and more recently, the temporary expansion of that authority granted through Advisory Bulletin 2008-AB-01.

For these reasons, we believe the final rule, while incorporating reasonable quantitative limits and prudential standards, should be written to preserve sufficient flexibility for the FHLBanks to invest in housing finance. These investments play a significant role for the FHLBank system as we safely and soundly exercise our housing finance mission

## **I. Quantitative and Other Limitations on MBS**

The NPR proposes to incorporate the current provision in the FHFB's FMP section II.C.2<sup>1</sup> that limits a Bank's level of investment in MBS and eligible ABS to 300 percent of its total capital into the final rule. We support retention of this limitation. Limits on a Bank's MBS investment authority ensure the Bank will not over-emphasize those investments at the expense of advances and, in conjunction with other restrictions on a Bank's MBS investments currently implemented through the FMP, impose reasonable constraints on the amount of interest rate and credit risk an FHLBank will assume through its investment portfolio. The authority to invest in appropriately conservative MBS securities can be seen as serving a Bank's need to invest its capital and excess liquidity to generate sufficient earnings and enhance achievement of the FHLBanks' primary mission of providing credit to member institutions. MBS investments represent a source of income that enable the FHLBanks to meet REFCORP and AHP obligations, cover operating expenses, build retained earnings, provide their members a reasonable dividend on their capital stock investment, as well as support the FHLBanks advance activity. Such investments also help provide stability of operations in the periods when a Bank's core products' balances are low.

We request that the 300 percent of total capital calculation be clarified and specified in terms of changes to GAAP. Specifically, the numerator should include amortized historical cost for HTM and AFS securities and fair value for trading securities. The denominator should include total capital as defined by FHFA regulation §1229.1<sup>2</sup>.

## **II. Limits or Restrictions on the Purchase of PLMBS**

Based on recent history in the markets and at the FHLBanks, we believe that establishing thoughtful PLMBS limits would be reasonable. We are supportive of the PLMBS regulatory and market enhancement principles currently under consideration by the Congress, SEC and federal banking regulators, including:

- Clear regulatory definitions and underwriting standards for traditional prime credit mortgage loans and the requirements applicable to PLMBS backed by such mortgages;
- Additional due diligence requirements for sponsors, servicers, master servicers and trustees participating in an PLMBS transaction;

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<sup>1</sup> A Bank may enter into agreements to purchase MBS, CMOs, REMICs, and eligible asset-backed securities so long as such purchases will not cause the aggregate book value of such securities held by the Bank to exceed 300 percent of the Bank's capital. A Bank may not increase its holdings of such securities in any one calendar quarter by more than 50 percent of its total capital at the beginning of that quarter.

<sup>2</sup> *Total capital* means the sum of the Bank's permanent capital, the amount paid-in for its Class A stock, the amount of any general allowances for losses, and the amount of any other instruments indentified in a Bank's capital plan that the Director has determined to be available to absorb losses incurred by such Bank. For a Bank that has issued neither Class A nor Class B stock, the Bank's total capital shall be the measure of capital used to determine compliance with its minimum capital requirement.

- Allowing significantly more time for investors to conduct a careful analysis before purchasing PLMBS;
- Increasing transparency by requiring that loan level data regarding a PLMBS transaction that an investor is considering for purchase be provided in a format and manner that is easily accessible by the investor;
- Requirements for meaningful, detailed ongoing disclosure (including without limitation loan level disclosure) about PLMBS issued; and
- Requiring originators to retain risk associated with securitized loans originated outside of federal loan guarantee programs.

Once the new legislative and regulatory requirements for issuance of PLMBS transactions have been established, the FHLBanks, like other investors in this market, will have a clearer understanding of the issues they will face as investors in such newly-issued PLMBS. At that point, the FHLBanks and the FHFA should consider risk parameters and limits with respect to PLMBS investments.

### **III. 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 FHLBanks' 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 FHLBanks' purchases of private-label MBS 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*<sup>3</sup> and *Statement on Subprime Mortgage Lending*<sup>4</sup>. We are in agreement with the FHFA's proposal that the principles outlined in the interagency guidance and the 2007 Advisory Bulletin, many of which are being expanded in the recent policy changes described in the preceding section, 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.

### **IV. Investment Grade Ratings for PLMBS**

We would support a requirement that all PLMBS purchased by a FHLBank be limited to securities with the highest investment grade rating at the time of purchase by an FHLBank in an effort to limit the potential risks to the FHLBanks from their MBS portfolios. As a practical matter, historically, the FHLBanks have operated in compliance with this standard in limiting its PLMBS purchases to the highest investment grade rating. Therefore, we are supportive of its incorporation into the final rule.

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<sup>3</sup> Issued on October 4, 2006 (71 FR 58609)

<sup>4</sup> Issued on July 10, 2007 (72 FR 27569)

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As is currently the case, an FHLBank should not be required to divest a PLMBS if the investment rating of the PLMBS falls subsequent to its purchase by an FHLBank.

If under the pending financial reform legislation the use of investment grade ratings are no longer permitted in FHFA rulemakings, other standards based on expected losses and credit enhancements could be established in future rulemakings.

We thank the FHFA for its consideration of these comments.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Ed Hjerpe III". The signature is fluid and cursive, with a large initial "E" and "H".

Edward A. Hjerpe, III

President & Chief Executive Officer