



July 6, 2010

*via Federal eRulemaking  
Portal and electronic mail to:  
RegComments@fhfa.gov*

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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 Des Moines (the “Des Moines Bank”) appreciates this opportunity to comment on the Federal Housing Finance Agency (“FHFA”) notice of proposed rulemaking (“NPR”) on Federal Home Loan Bank (“FHLBank”) investments. The NPR would re-organize and re-adopt existing investment regulations for the FHLBanks that were previously adopted by the Federal Housing Finance Board (“FHFB”) and incorporate into these regulations limits on FHLBanks’ investments in mortgage-backed securities (“MBS”) and certain asset-backed securities. These limits are currently set forth in the Financial Management Policy (“FMP”). In the NPR, the FHFA also seeks comments on whether it should adopt additional restrictions, or lower the overall limit, on the FHLBanks’ investments in MBS generally, and particularly in private-label MBS (“PLMBS”).

Initially, we would like to highlight the statutory authority the FHLBanks have to invest in MBS and the important role this authority has played in fulfilling their mission. In sections 11 and 16 of the FHLBank Act<sup>1</sup> (the “Act”), Congress sets forth specific investment authorities of the FHLBanks. These sections do not pose any quantitative limits on these authorities, but do allow the FHFA to do so. Over the years, Congress has broadened the FHLBanks’ investment authorities to include not only Agency obligations, but also “participations or other instruments of or issued by” the Agencies, to allow the FHLBanks to indirectly contribute to housing finance, recognizing the FHLBanks as important investors in the secondary market. This legislative history clearly demonstrates that MBS investments are an integral part of the FHLBanks’ housing finance mission and a mission-related activity.

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<sup>1</sup> 12 U.S.C. 1431(h)

The FHFA's predecessor, the FHFBS, acknowledged the importance of MBS investments to the FHLBanks' housing finance mission during the most recent credit crisis. On April 3, 2008, the FHFBS issued Advisory Bulletin 2008-AB-01 ("2008-AB-01"), which temporarily increased the FHLBanks' investment authority in MBS, permitting them to "purchase and hold MBS in an amount up to six times its capital, but all MBS purchases must be investments in Agency MBS when existing MBS investments exceed three times capital." This temporary authority expired on March 31, 2010.

According to 2008-AB-01, by allowing the FHLBanks to purchase additional Agency MBS, "the Finance Board intends to further its statutory housing finance mission..." In addition, the FHFBS stated: "[T]his action can increase the demand for Agency MBS, the added liquidity could help to restore the market for these securities and could, in turn, lead to lower liquidity premiums, lower mortgage rates, and increased home purchases." Also in this release, former FHFBS Chairman Ronald Rosenfeld stated, "The Federal Home Loan Bank System plays a vital role in helping to finance homeownership and strengthening the economy at large. Increasing the Agency MBS investment authority for the FHLBanks is another way in which the system can perform its traditional mission." In a separate release, FHFBS member Geoff Bacino noted this quick action by the FHFBS should "help alleviate the current crisis in the mortgage markets." These various statements exemplify the reliance on and implied expectation of the FHLBanks to support the secondary mortgage market through MBS investments. This is especially important in times of market disruptions.

There has been a compelling need to restart the secondary mortgage market, and the FHLBanks' MBS investment authority has been an important factor in achieving that goal. The Des Moines Bank played a key role. Utilizing the authority granted by 2008-AB-01, the Des Moines Bank made significant investments in additional Agency MBS containing qualifying mortgages originated after January 1, 2008. At March 31, 2010, the Des Moines Bank held MBS investments totaling \$14.3 billion (\$14.2 billion Agency MBS, \$0.1 billion PLMBS). The FHLB system had \$152 billion invested in MBS at December 31, 2009 (\$104 billion Agency MBS; \$48 billion PLMBS).

We would also note that FHLBank investments generally have been prudent ones. MBS investments held by the Des Moines Bank are almost entirely agency-issued. The small amount of PLMBS investments was acquired prior to 2005; later PLMBS investment opportunities did not satisfy the risk/return criteria of the Des Moines Bank. The recent losses suffered by some FHLBanks with regard to their investments in investment-grade PLMBS, which would still be permissible under the proposed regulations, are more a reflection of unprecedented market disturbances rather than lax regulatory standards specific to all FHLBanks. As noted below, market participants and the regulatory community are considering broad market reform proposals that are intended to protect against such losses occurring in the future.

In addition, we would note that our Bank's investments have supported our ability to provide low-cost advances, dividends to our members, and grants through our Affordable Housing Program (AHP). Our investments in MBS and Housing Finance Agency bonds specifically have provided housing finance funds to homeowners in our region.

For these reasons, we believe the final rule should be written to provide the FHLBanks maximum flexibility to invest in housing finance, whether through making advances, acquiring mortgages

directly from members, or holding MBS. All of these activities and investments have a significant positive effect on the evolving housing finance system and play a significant role in ensuring that the FHLBanks can safely and soundly exercise their housing finance mission. Any investment restrictions deemed necessary by the FHFA can be imposed on a case-by-case basis as part of the FHFA's normal safety and soundness oversight responsibilities.

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

The NPR proposes to incorporate into the final rule the current provision in the FMP section II.C.2<sup>2</sup> that limits a Bank's level of investment in MBS and eligible ABS to 300 percent of its total capital. Rather than codifying this inflexible and potentially outdated limitation as a regulation, we believe that this is a good time for the FHFA to review the need for and appropriateness of such a limitation, especially as it relates to Agency MBS and especially given the current need for a reliable source of housing finance funds.

As mentioned earlier, the Act imposes no quantitative limits on FHLBank investments in MBS. Instead, the quantitative limit being proposed here is one that the FHFA is proposing under its own regulatory initiative. In past rulemakings, the FHFBA noted that its limitations on MBS investments were based more on mission concerns rather than concerns regarding safety and soundness.<sup>3</sup> The recent increase in the quantitative limit on Agency MBS to six times capital demonstrates that a higher limit for Agency MBS does not by itself pose safety and soundness concerns. The safety and soundness issues relate to how each FHLBank utilizes the investment authority available, and how it manages the risks associated with the investments made. Also, as discussed earlier in the letter, the recent increase in the limit also demonstrates how FHLBank investments in MBS provide a very important benefit to housing finance.

Furthermore, the authority to invest in MBS can be seen as serving an FHLBank's need to invest its capital and excess liquidity to generate sufficient earnings and have available sufficient credit for its members. MBS investments also 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 an FHLBank's core product balances are low.

Because of these benefits, we request that the FHFA reconsider the 300-percent-of-total-capital limit on MBS investments and replace it with one that provides the FHLBanks more flexibility in their investments. We also request that the FHFA provide a regulatory justification and analysis for any limit that it does codify. We believe this justification is important from a substantive perspective given the recent positive experiences with a higher limit for Agency MBS and from a procedural perspective

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<sup>2</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>3</sup> See 65 Fed. Reg. 25676, 25677 (May 3, 2000). "The Finance Board initially limited MBS investment by the Banks in part because of concern about the Banks' ability to manage the interest rate and options risk associated with these assets. However, now that the Banks have developed more effective techniques for hedging these risks, and there are policy limits in place constraining the Banks' interest rate risk exposure, the MBS limit can be viewed less as a safety and soundness constraint and more as a means to restrain a non-mission-related activity."

given that Congress has not imposed such a limit by statute. We would disagree with the FHFA if it were to find that MBS investments are not a mission-related activity. The Act indicates otherwise and our own Bank's experience would indicate that such investments are an important part of our housing mission.

In addition, we request that, if a limit is adopted, the calculation for the limit 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>4</sup>.

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

With respect to PLMBS, in view of the extensive regulatory and market changes that are underway with respect to this market and the current uncertainty surrounding these efforts, we believe that establishing specific PLMBS limits or restrictions at this time is premature. We suggest that the FHFA defer any regulatory action focused on PLMBS in light of the various 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;
- 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; and
- Requirements for meaningful, detailed ongoing disclosure (including without limitation loan level disclosure) about PLMBS issued.

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 potential investors in such newly-issued PLMBS. At that point, each FHLBank will be able to establish its risk parameters and limits with respect to its PLMBS portfolio in its Board-approved investment policy. These risk parameters and policy limits, like other aspects of an

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<sup>4</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 identified 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.

FHLBank's credit and investment policies, would be subject to review by the FHFA as part of the supervisory process.

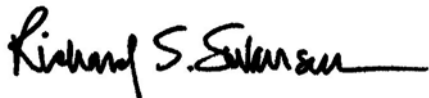
### **III. Characteristics and Restrictions on Collateral of PLMBS Purchases**

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>5</sup> and *Statement on Subprime Mortgage Lending*<sup>6</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.

Furthermore, collateral-specific restrictions are ineffective due to varying enhancement features found in PLMBS securities. As the most recent crisis has proven, collateral performance has not been highly correlated to security performance. In fact, there are many examples of securities with highly delinquent collateral pools which have outperformed securities with better performing collateral pools due predominantly to structural differences between such securities.

We thank the FHFA for its consideration of these comments.

Respectfully submitted,

A handwritten signature in black ink that reads "Richard S. Swanson". The signature is written in a cursive, flowing style with a long horizontal line extending to the right.

Richard S. Swanson, President & CEO

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<sup>5</sup> Issued on October 4, 2006 (71 FR 58609)

<sup>6</sup> Issued on July 10, 2007 (72 FR 27569)