BY EMAIL AND FEDERAL EXPRESS

January 7, 2010

Alfred M. Pollard, General Counsel
Federal Housing Finance Agency
Fourth Floor
1700 G Street, NW
Washington, DC 20552

Re: Comments on Proposed Rulemaking Regarding Federal Home Loan Bank Liabilities; RIN 2590—AA36

Dear Mr. Pollard:

On November 8, 2010, the Federal Housing Finance Agency (FHFA) issued a proposed rule[1] to redesignate and make certain changes to Parts 965, 966, 969, and 987 of Federal Housing Finance Board regulations. In the preamble to the proposed rule, the FHFA discussed Section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Section 939A), which obligates the agency to review all of its regulations that require the use of an assessment of the creditworthiness of a security or money market instrument (the Relevant Regulations), and solicited comments on the FHFA's implementation of this statutory mandate. This letter sets forth comments of the undersigned Federal Home Loan Banks with respect to Section 939A implementation.[2] We thank you for the opportunity to be heard on this important matter.

After the FHFA conducts its required review of the Relevant Regulations[3], the agency must then act to modify those regulations (a) to remove all references to or requirements of reliance on credit ratings[4] and (b) to substitute for those references or requirements such replacement standards of creditworthiness as the FHFA shall determine are appropriate for such regulations (Replacement Standards). We appreciate the considerable task faced by the FHFA in developing Replacement

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[1] 75 F.R. 68534 (2010).

[2] The comments set forth herein are in addition to the comments made by certain of the undersigned Banks pursuant to one or more separate comment letters regarding the application of Section 939A to the Federal Housing Finance Board's acquired member assets regulations.

[3] Note that there may be regulations that contain references to credit ratings but fall outside of the scope of Section 939A because they do not relate to "a security or money market instrument" within the meaning of Section 939A(a)(1). For example, to the extent the 12 CFR §932.9(a) limits on unsecured extensions of credit rely on issuer credit ratings, rather than credit ratings for particular securities or instruments, such limits arguably fall outside of the confines of the Relevant Regulations. For the same reason, proposed section 1270.5(c)'s requirement that each FHLBank maintain a minimum issuer credit rating may also be outside of the scope of Section 939A.

[4] Section 939A does not provide a definition of "credit ratings." We assume for purposes of this comment letter that "credit ratings" in Section 939A means credit ratings issued by a Nationally Recognized Statistical Ratings Organization (NRSRO).

Standards, and we hope that you find our comments constructive as you begin this process.[5] It is the undersigned Banks' view that the development of the Replacement Standards should reflect the following principles.

The FHLBanks should be permitted to use NRSRO credit ratings as a factor in determining whether a particular security meets the level of creditworthiness reflected in a Replacement Standard. Section 939A by its terms obligates the FHFA to remove all references to credit ratings and all requirements to rely on credit ratings from the Relevant Regulations. What Section 939A does not do, however, is bar the FHFA from permitting the FHLBanks to use NRSRO credit ratings as a factor in determining whether financial assets meet the levels of creditworthiness reflected in the Replacement Standards. This is clear from both the text and legislative history of Section 939A.

Section 939A can be traced back to the financial regulatory reform bill passed by the House of Representatives on December 11, 2009.[6] The House bill used almost identical wording to that ultimately contained in Section 939A.[7] The financial regulatory reform bill reported out of the Senate Banking Committee on April 15, 2010,[8] on the other hand, required federal agencies to both remove references to credit ratings from regulations and substitute replacement standards that "[are] not related to credit ratings." This latter concept was removed before the full bill was passed by the Senate on May 20, 2010, and does not appear in the final legislation.

Thus, the Senate specifically considered -- but then specifically rejected -- prohibiting federal agencies from issuing replacement creditworthiness standards that were "related to" NRSRO credit ratings. Based on this legislative history, we believe the most faithful reading of Section 939A would permit the FHFA to issue Replacement Standards that have a relationship to NRSRO credit

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[5] We would also hope and expect that the FHFA will monitor similar rulemakings of other federal agencies like the FDIC and OCC as they grapple with the same issue and consult with such other agencies as appropriate.

[6] *See* Wall Street Reform and Consumer Protection Act, H.R. 4173, 111th Cong. § 6010 (as passed by the House of Representative Dec. 11, 2009).

[7] Sections 6010(a)(1) and (2) read as follows:

"(1) REVIEW- Not later than 1 year after the date of the enactment of this subtitle, each Federal agency listed in paragraph (4) shall, to the extent applicable, review--
(A) any regulation issued by such agency that requires the use of an assessment of the credit-worthiness of a security or money market instrument; and
(B) any references to or requirements in such regulations regarding credit ratings.

(2) MODIFICATIONS REQUIRED- Each such agency shall modify any such regulations identified by the review conducted under paragraph (1) to remove any reference to or requirement of reliance on credit ratings and to substitute in such regulations such standard of credit-worthiness as each respective agency shall determine as appropriate for such regulations. In making such determination, such agencies shall seek to establish, to the extent feasible, uniform standards of credit-worthiness for use by each such agency, taking into account the entities regulated by each such agency and the purposes for which such entities would rely on such standards of credit-worthiness."

[8] *See* S. 3217, 111th Cong. § 939(d)(2) (as reported by S. Comm. on Banking, Housing and Urban Affs., April 15, 2010).

ratings,[9] so long as the Replacement Standards do not either refer to those ratings or require their use.

The undersigned Banks urge the FHFA to exercise its discretion under Section 939A to permit FHLBanks to continue to use NRSRO credit ratings and other analytical data prepared by third-party service providers in their credit assessments of investments and counterparties, subject to the requirement that each FHLBank must assess the appropriateness of reliance on such credit ratings or other third-party analytics. While the FHLBanks do not and should not rely mechanistically on NRSRO credit ratings to determine creditworthiness, such ratings remain a useful tool for an FHLBank to use in making determinations as to whether a particular financial asset is investment grade, notwithstanding the well-publicized failures in the ratings process that occurred in the last several years. Credit ratings are independent third-party assessments that are transparent, easily comparable, and easily available. They reduce information costs and promote liquid markets, using the advantage of economies of scale, particularly in collecting and analyzing large amounts of data.

As long as an FHLBank is mindful of its ultimate responsibility for making creditworthiness assessments, there is no compelling reason to categorically exclude the use of NRSRO credit ratings by FHLBanks in making determinations as to whether a particular asset meets the level of creditworthiness reflected in particular FHFA regulations. This is especially so in light of the ongoing reform of the NRSRO ratings process -- initiated by both market forces and the Dodd-Frank Act -- and the real possibility that these reforms succeed in improving the accuracy and reliability of credit ratings.

The FHLBanks' existing regulatory authorities to acquire investment grade assets should not be removed; rather, they should be modified to place the responsibility on each FHLBank to match particular assets to the various investment grade definitions. The FHLBanks rely on the existing authorities set forth in the Relevant Regulations to invest in conservative, high quality assets. We believe the concept of requiring, for different regulatory purposes, that particular assets meet particular creditworthiness criteria is sound, and should (and may, consistent with Section 939A) be retained, subject to appropriate modification pursuant to the statutory mandate.

For example, in the computation of eligible assets for purposes of compliance with the negative pledge requirement, the FHLBanks currently have the authority to include any security rated AAA by an NRSRO.[10] We would propose that the Replacement Standard for this provision continue to permit the FHLBanks to include all securities meeting the definition for a high investment grade asset,[11] but place the onus for matching particular assets to that definition on each FHLBank. The

[9] For example, if regulated entities opt to use NRSRO credit ratings as a factor to determine whether an asset meets the Replacement Standards, it is fair to characterize that use as a relationship between credit ratings and the Replacement Standards.

[10] *See* 12 CFR 966.2(c)(6), which permits the inclusion in eligible assets of any security that has been assigned an NRSRO rating at least the equivalent of that assigned to consolidated obligations outstanding.

[11] The Replacement Standards could and should include ratings definitions similar to those currently used by the NRSROs. Section 939A does not bar a regulatory agency from adopting a set of ratings definitions that are similar or identical to that used by the NRSROs. What matters for Section 939A purposes is that the regulated entity (rather than an NRSRO) is ultimately responsible for matching individual assets to the definition.

Replacement Standards should require the FHLBanks to develop and implement appropriate policies and procedures to ensure their credit assessment processes are consistent with safety and soundness standards, including policies and procedures regarding the extent to which those processes may make use of NRSRO credit ratings and other third-party analytics.[12] Those credit assessment processes would continue to be subject to robust review by the FHFA through the examination process.

An alternative approach, in which the FHLBanks' existing authorities to invest in conservative, high-quality assets are simply removed from the Relevant Regulations, should be rejected. Such an approach is inconsistent with both the letter and spirit of Section 939A, which contemplates that a covered agency should replace existing NRSRO-dependent regulatory provisions with appropriate substitute standards of creditworthiness, not remove the concept of creditworthiness from the regulations altogether. In addition, it is our view that preserving existing flexibility in the FHLBanks' investment authority is especially critical at a time when many FHLBanks are increasing capital levels. Capital conservation efforts will be less successful for the FHLBanks without the ability to invest such additional capital in an economic manner.

After the FHFA formulates proposed Replacement Standards, the agency should provide a review and comment period to enable the FHLBanks and other interested parties the opportunity to respond to them before they become effective. In light of the importance and complexity of this issue across a number of different areas of agency regulations, we strongly believe that the FHLBanks and other interested parties should have the opportunity to review and comment on specific Replacement Standards before any final rules implementing Section 939A are issued. In addition, any such final rules should include an appropriate phase-in period and grandfathering of existing positions. A robust phase-in period would be particularly critical in the event that the FHFA -- contrary to our comments set forth above -- opts to bar all FHLBanks from any reliance on NRSRO credit ratings to determine compliance with regulatory requirements, since in that case we would require significant lead time to put in place new platforms to replace the use of that credit assessment tool. We believe that providing a separate notice and comment period for the Replacement Standards, a phase-in period for the effectiveness of the final rule, and grandfathering of existing positions are all consistent with the timeline set forth in Section 939A, which does not set a deadline for the FHFA's issuance of final Replacement Standards, but merely requires a review of the Relevant Regulations by July 21, 2011.

Thank you for your consideration of our comments.

[12] We would expect that an FHLBank's reliance on NRSRO credit ratings and other third party analytics would be more extensive with respect to simpler, more liquid assets. More complex, illiquid assets may demand a higher degree of scrutiny pursuant to internally-developed credit models. We would also expect that an FHLBank may rely more heavily on NRSRO credit ratings and other third party analytics in the short term after the Replacement Standards become effective, with that reliance reducing over time as an FHLBank continues to develop even more sophisticated internal approaches to credit assessment.

Sincerely,

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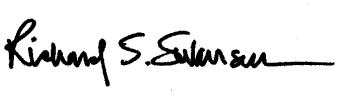

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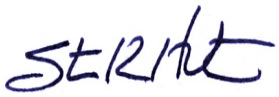

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