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VIA E-MAIL – RegComments@FHFA.gov

Alfred M. Pollard
General Counsel
Christopher T. Curtis
Sr. Deputy General and Managing Counsel
Federal Housing Finance Agency
1700 G Street N.W., 4th Floor
Washington, DC 20552

Re: Securitization Study Comment Letter to Federal Housing Finance Agency

Dear Messrs. Pollard and Curtis:

We are writing on behalf of our clients the Federal Home Loan Banks of Cincinnati, Indianapolis, and Boston, with input from the Federal Home Loan Banks of Atlanta, Chicago, Des Moines, and Topeka (collectively, the "Participating FHLBanks") in connection with your Notice of Concept Release (the "Concept Release") regarding the Federal Housing Finance Agency ("FHFA") Study of Securitization of Acquired Member Assets.[1] David Hehman, the President of the FHLBank of Cincinnati, has coordinated this comment among the Participating FHLBanks. In the Concept Release, the FHFA requested public comment on several questions with respect to a possible securitization program in the Federal Home Loan Bank System (the "System") to assist with the preparation of a report to Congress by July 30, 2009. The public comments are expected to provide information that will assist you in the preparation of the report.

I. Authority of FHLBanks to Engage in Mortgage-Related Activities

A. Overview

The Housing and Economic Recovery Act of 2008 ("HERA") requires the FHFA to conduct a study and report to Congress on the securitization of home mortgage loans purchased or to be purchased from member financial institutions ("Member") under the Acquired Member Assets ("AMA") programs.[2] HERA requires that the study address the following points: (i) benefits and risks associated with securitization of AMA; (ii) the potential impact of securitization upon

[1] 74 Fed. Reg. 8955 (2009).
[2] Pub. L. 110-289, 122 Stat. 2654, 2791-2792 (2008).

liquidity in the mortgage and broader credit markets; (iii) the ability of the Federal Home Loan Banks ("FHLBanks") to manage the risks associated with a securitization program; (iv) the impact of such a securitization program on the existing activities of the FHLBanks, including their mortgage portfolios and advances; and (v) the effects of a securitization program on joint and several liability of the FHLBanks and the cooperative structure of the System.

B. AMA Regulation

In July 2000, the Federal Housing Finance Board ("FHFB") adopted a final regulation to authorize FHLBanks to acquire AMA assets.[3] The AMA Regulation authorizes FHLBanks to hold certain assets acquired from or through the Members by means of either a purchase or funding transaction where the AMA assets are held for a valid business purpose by a Member prior to acquisition by an FHLBank. In order for an FHLBank to acquire a mortgage loan as AMA, the loan must be acquired either from (i) a Member of the acquiring FHLBank; (ii) a Member of another FHLBank pursuant to an arrangement with that FHLBank; or (iii) another FHLBank.

AMA loans must meet the requirements set forth under a three-part test established by the AMA Regulation. The three-part test consists of a loan type requirement; a Member or housing associate nexus requirement; and a credit risk-sharing requirement.[4] The loan type requirement establishes the types of assets that could be considered as AMA-eligible. Assets acquired by an FHLBank must fall within certain categories. For example, the assets may be whole loans eligible to secure advances that do not exceed the conforming loan limits that apply to Fannie Mae and Freddie Mac. Members must provide a credit enhancement sufficient to enhance the credit quality of the assets to an equivalent of an instrument rated at least investment grade (*e.g.*, BBB), although all approved AMA programs require Members to enhance the loans to the second highest investment grade (*e.g.*, AA). Members may provide this credit enhancement through various means.

C. Experience with AMA Programs

The AMA Regulation governs participation in the AMA programs created by the FHLBanks and would cover a securitization program. To date, two separate mortgage programs are authorized under the AMA Regulation - the Mortgage Partnership Finance[5] ("MPF®") Program and the Mortgage Purchase Program ("MPP").[6] Mayer Brown provided the initial legal advice with respect to the design of the MPF Program and MPP.

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[3] 65 Fed. Reg. 43969 (2000) (codified at 12 C.F.R. Part 955) (the "AMA Regulation").

[4] 12 C.F.R. § 955.2.

[5] "Mortgage Partnership Finance," "MPF," and "MPF Shared Funding" are registered trademarks and "MPF Xtra" is a trademark of the FHLBank of Chicago.

[6] While MPP and the MPF Program have experienced risk challenges in some FHLBank districts, primarily related to interest rate risk, the programs continue to fund a significant number of Member home mortgages. As of December 31, 2008, AMA assets held on the balance sheets of the FHLBanks were $87.4 billion, down 4.6% from the prior year. As the mortgage markets stabilize, it is anticipated that FHLBanks actively engaged in these

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The AMA products are structured such that the FHLBanks acquire, through either a purchase or funding transaction, whole, single-family mortgage loans from their Members. Products exist for both conventional and government-insured loans. The risks associated with the mortgages are such that the FHLBank manages the interest-rate risk and the Member manages the risks associated with originating the mortgage, including a substantial portion of the credit risk.

D. Legal Authority for AMA Programs

The Concept Release expressly provides that it does not alter current requirements, restrictions, or prohibitions on the FHLBanks with respect to the purchase or sale of mortgages or to the existing AMA programs. The authority to purchase AMA loans is clear under the AMA Regulation and Federal Home Loan Bank Act ("the FHLBank Act"). This authority was affirmed by the U.S. Court of Appeals for the Fifth Circuit in *Texas Savings & Community Bankers Association v. Federal Housing Finance Board.*[7] While major amendments were made to the FHLBank Act in 1999 by the Gramm-Leach-Bliley Act and more recently by HERA, the FHLBanks' central mission remains that of providing funding for housing finance, so the underlying reasoning in *Texas Savings* remains valid.

E. Securitization of FHLBanks' AMA

While securitization would extend beyond the FHLBanks' current mortgage programs, the existing statutory and regulatory authority for these AMA programs would also support a securitization program. As discussed above, the FHLBanks have the authority to purchase AMA loans and establish AMA programs. To the extent that the FHLBanks acquire AMA loans, they should have the inherent authority to dispose of those loans whether by securitization or otherwise. The FHFB previously approved the securitization of AMA loans under the MPF Shared Funding® securities issued by a Member in 2003.[8] The FHFA has already acknowledged the existence of this inherent authority by expressly recognizing the authority of the FHLBanks to sell AMA loans, as well as participations in AMA loans to other FHLBanks.[9] Given this

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programs will see an increase in new purchases. This increase in volume will be offset with AMA prepayments as the mortgages refinance. As initially planned in the program design, securitization of certain AMA products would likely assist an FHLBank in better managing its risks and reducing its on-balance-sheet mortgage holdings to make room for new purchases.

[7] 201 F.3d 551 (5th Cir. 2000).

[8] MPF Shared Funding Mortgage Pass-through Certificates Series 2003-1 and 2003-2 were issued by One Mortgage Partners, LLC, an insurance company member of the FHLBank of Chicago, with the unsubordinated securities of these two series being acquired by the FHLBanks of Chicago, Des Moines and Pittsburgh.

[9] 12 C.F.R. § 955.1. Other examples of sales involving AMA loans include the FHLBank of Seattle's sale of $1.4B of whole loans in 2005 and the sale of loans to Fannie Mae by the FHLBank of Chicago under the MPF Xtra™ product. This conclusion is also supported by prior precedent. See, *e.g.*, Legal Memorandum from Beth Climo, FHFB General Counsel, to J. Stephen Britt, FHFB Executive Director, dated May 3, 1991; *see also*

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authority to sell AMA loans and the close nexus between a sale and a securitization of sold assets, the authority to sell AMA loans should, in itself, demonstrate legal authority for the FHLBanks to undertake a securitization program without changes to the FHLBank Act or significant changes to the AMA Regulation.

Even if the FHLBanks will guarantee the payment of principal and interest for the mortgage-backed securities issued as part of a securitization program, the FHLBank Act should permit such a guarantee. Section 11(a) of the FHLBank Act provides that the FHLBanks, subject to rules and regulations prescribed by the FHFA, may borrow and give security and pay interest thereon, to issue debentures, or other obligations upon such terms and conditions as the FHFA may approve.[10] The authority in Section 11(a) provides the FHFA with the latitude to permit the FHLBanks to create securitization programs to the extent that the guarantee provided is an "obligation," as such term is used in the FHLBank Act.

Finally, the request of Congress to have the FHFA study securitization (HERA Title II, Sec. 1215) asks the FHFA to review the benefits and risks of securitization, including the impact of securitization on AMA loans purchased or to be purchased. Congress must presume that the legal authority already exists because nowhere in the detailed study request was the authority question asked to be reviewed or reported on. Implicit in the study is the assumption that the authority exists in the FHLBank Act for the FHLBanks to buy and sell mortgages through the use of guarantees, subject to FHFA regulation.[11]

II. Support for FHLBank Securitization Program

A. Purpose of FHLBanks and AMA Programs

The purpose of the AMA programs is to promote homeownership by (i) providing an alternate secondary mortgage loan market to Members, (ii) sharing a limited amount of the loan credit risk with Members, and (iii) providing Members the opportunity to benefit financially by the performance of the mortgage loans sold. The volatility in the credit markets over the past 18 months has reinforced the U.S. housing economy's need for stable sources of mortgage financing in addition to sources that have been proven stable throughout the crisis, such as those already provided by the FHLBanks to their Members, including through their AMA programs. A securitization program would enable the FHLBanks to increase their role in providing such stability, because FHLBanks would not need to carry all acquired mortgage loans on their balance sheet until maturity.

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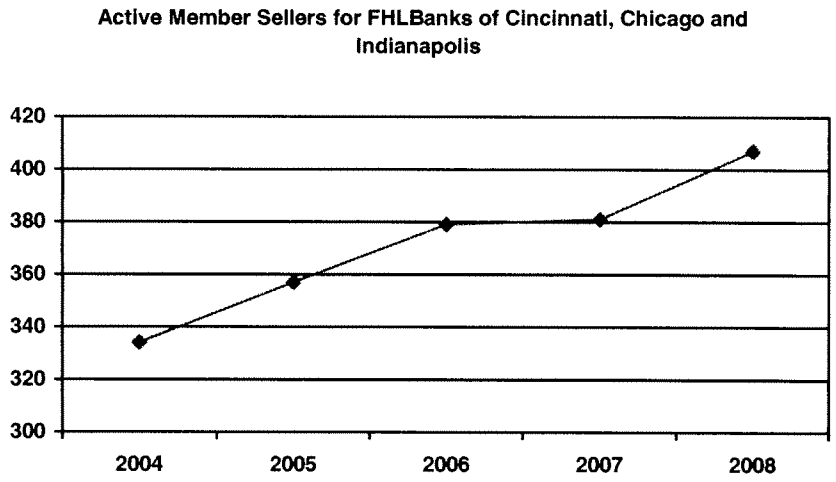
Securities Industry Association v. Clarke, 885 F.2d 1034 (2d Cir. 1989) *cert. denied* 493 U.S. 1070 (1990) (upholding the ability of national banks to securitize assets lawfully held by the bank).

[10] 12 U.S.C. § 1431(a).

[11] For a closely related example of where a Court used a Congressional study request to confirm an FHLBank power, see *Texas Savings*, 201 F.3d at 555, footnote 4.

Members of FHLBanks are typically federally-chartered and state-chartered savings institutions, credit unions, commercial banks, and insurance companies. Most of the Members are smaller institutions that could not securitize their own loans and may find it costly to directly sell their loans to Fannie Mae and Freddie Mac. The AMA programs have provided these smaller institutions with an opportunity to sell their mortgage loans at prices competitive to those of the large mortgage originators, and receive better returns due to the risk-sharing arrangement.

Because the Members retain some interest in the performance of the loans after sale, the AMA programs promote responsible underwriting of mortgage loans by the lenders. This shared credit risk is an important feature of the AMA program and would remain part of any securitization program. Despite the recent challenges to the AMA programs, active Member sellers continue to increase.



As the financial marketplace continues to evolve, the FHLBanks must provide meaningful opportunities and benefits to their Members. While advances to Members are beneficial and will remain the primary source of revenue, it is important that the FHLBanks be able to expand their existing mortgage loan financing efforts, which are currently balance sheet-constrained and, as well, offer new, reliable funding alternatives to their Members. A securitization program for AMA loans could be an avenue to expand existing mortgage loan financing efforts or offer new financing alternatives, which could be an important long-term benefit of FHLBank membership. Securitizations will also allow an FHLBank that is balance sheet-constrained from a risk perspective to continue to purchase AMA and then transfer that investment and some of the associated risks to third parties.

B. Financial Viability of a Securitization Program

(i) Role for FHLBanks in Current Marketplace

The Participating FHLBanks believe that mortgage-backed securities with underlying AMA loans are superior to other types of mortgage-backed securities. Historically, AMA loans have had lower default rates due to the risk-sharing agreement with the Member and stringent underwriting. This translates into more stable cash flow characteristics and a better performing asset. Similarly, because these loans are originated through highly regulated Members, the prepayment characteristics are more predictable, which will be highly valued and demanded by investors, such that these FHLBank-issued mortgage-backed securities will receive favorable pricing relative to other mortgage-backed securities. Benefits of this favorable pricing will be passed on to Members both in terms of more favorable risk-sharing arrangements with the Members as well as in more general benefits in Members' capacities as FHLBank shareholders and the overall FHLBank value proposition. Providing low-cost funding in support to the housing market through Members is the core element of the FHLBank mission.[12]

(ii) Effect on Advance Program

Affording Members the flexibility to sell mortgage loans to an FHLBank under an AMA credit enhancement structure under which the loans would be securitized will provide them with a valuable alternative to holding those loans in portfolio or selling them to the FHLBank of Chicago under the MPF Xtra™ product, which does not utilize an AMA credit enhancement structure. Continued involvement by Members in the performance of the loans through an AMA credit enhancement structure provides Members with strong incentives to originate high quality mortgage loans and to provide high quality servicing for such loans.[13] Historically, larger Members securitized loans in private label transactions or with Fannie Mae and Freddie Mac. In today's market, investor appetite for private label mortgage loan securitizations remains very modest. The Participating FHLBanks believe that the level of participation among Members will vary from Member to Member and may well also be subject to variation from time to time for any particular Member. In any event, the option to securitize is, in and of itself, valuable to Members. The Participating FHLBanks believe that providing Members this option would not adversely affect the viability of their advances programs. The FHLBanks' experience with MPP and the MPF® Program (which, from the perspective of the Member, may be very similar to securitization) supports this view.

Having complementary product offerings reinforces the value of Members' voluntary investment in an FHLBank to access liquidity, primarily for housing finance. It also gives the smaller

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[12] As cooperatives without publicly traded stock, securitizations do allow for another form of investment capital to flow into the FHLBanks.

[13] While the MPF Xtra™ product provides Members with an opportunity to sell mortgage loans, a securitization program would provide Members with several additional benefits. First, it would provide Members with an alternative to relying on Fannie Mae and Freddie Mac. Second, the value received by Fannie Mae in MPF Xtra™ loans can be captured by the FHLBanks and Members via the cooperative nature of the System. Finally, housing finance is the historic mission of the FHLBanks and to be effective in serving Members, the FHLBanks need control over the products and pricing.

Member that otherwise does not have good secondary market access the option to decide whether to sell or hold mortgages in portfolio funded by an FHLBank.

(iii) Effect of the Development of a Covered Bond Market

Historically, covered bond investors purchasing interests in mortgage pools held on balance sheet have been primarily "rate" investors - that is, investors not seeking compensation for taking prepayment or credit risk. To the extent that this traditional covered bond market re-emerges outside the United States (and emerges anew here), it should continue to attract "rate" investors. Collateralized mortgage obligations ("CMO") investors bear prepayment risk and often bear credit risk. While covered bond investors may well overlap somewhat with traditional CMO investors, the Participating FHLBanks believe that the covered bond product and securitized product are different and complementary for both investors and issuers. Diverse, innovative financial products, which channel investment capital back into the housing market, are greatly needed. This is especially true in cases where the investments are intermediated to Members; as highly regulated entities they have a track record of prudently originating home mortgage products appropriate for the nation's consumers.

(iv) Investments by the FHLBanks in Securitization Infrastructure

Launching an FHLBank securitization program will entail a variety of investments in new and existing resources. This is primarily due to the initial investment that is required to develop the program and the degree to which computer systems are integral to the process. Many existing MPP and MPF® systems were designed with securitizations and loan master servicing in mind.

A sample of the types of investments includes:

- Computer systems represent a large initial and ongoing cost. These ongoing costs include the expense of web hosting, maintenance, and upgrades of the software. When the provider owns the computer software, the marginal cost of additional volume is minimal.

- Master servicing is the automated management of the routine data flows from Member servicers, consolidation of detailed loan data, and provision of certain accounting data. This is likely an outsourced function and, as such, is a variable cost.

- Additional financial risk and capital management expertise.

- Strategic management is the evolution of the business model to respond to opportunities and threats that are posed by the legal, regulatory, and business environment. These costs often include legal, accounting, and consulting costs, in addition to the time of senior management and the board of directors.

- Quality control involves the detailed review of a statistical sample of loans purchased from each Member to determine compliance with program guidelines. This is typically an outsourced function.

- Member interaction includes Member recruitment and approval, contract administration, and ongoing marketing of loans to be delivered. FHLBank staff typically handles these functions.

- Marketing and servicing of the investor securities. This might be done by a newly established joint office or offices controlled by the participating FHLBanks. HERA Title II, Section 1204 now allows for this by lifting the prohibition against establishing joint offices.

- Monitoring and costs of targeted housing goals and the census track public use database for loans purchased to comply with the new HERA requirements.[14]

In general, the cost of AMA and securitization programs is responsive to scale. The Participating FHLBanks believe that the expected securitization volumes would be sufficient to justify the System investments of the type described above. The Participating FHLBanks also believe that a successful securitization program is possible without reaching the same level of loan sale volumes achieved by Fannie Mae and Freddie Mac. This is true in part because of the cooperative nature of the System and the FHLBanks' mission of Member service rather than simply maximizing shareholder value.

Before the final design and implementation may start and future development costs are incurred, the FHLBanks need and request clear guidance from the FHFA that securitization programs are authorized, and if appropriately designed to protect safety and soundness, are permissible new business activities for the FHLBanks. Also note that if delivery volumes are sufficient, a new TBA market could be created, where under flow agreements with predetermined price spreads, multiple FHLBanks could deliver mortgages into the security. This would assist in hedging the pipeline risk.

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[14] 12 U.S.C. §§ 1430(k) and 1430c.

III. Structure of Securitization Program and Associated Questions

A. Securitization Structure

The Participating FHLBanks believe that securitization of loans is best accomplished by centralizing related functions in a new joint office or the Office of Finance.[15] FHLBanks (and their Members) will benefit from the scale and expertise concentrated in a single platform designed to serve the collective needs of participating FHLBanks. Investors in FHLBank securitized products should benefit from the liquidity inherent in a deeper secondary market for homogeneous securities. While the securitization activities need not be conducted by the System as a whole, the Participating FHLBanks do believe that a critical minimum level of participation is necessary to maximize the probability of wide investor acceptance and efficient execution. However, just like the AMA programs, securitization does not require participation by all the FHLBanks. Given that each FHLBank is Member-owned and governed by its own regional board of directors, participation should be a business decision for each FHLBank based on mission and the risk-return analysis.

For several reasons, the Participating FHLBanks believe the preferred approach is that securitized debt issued by the new office or Office of Finance should be guaranteed by all or most of the FHLBanks. First, to be attractive to investors, securities issued by an FHLBank program must be competitive with guaranteed mortgage-backed securities issued by Fannie Mae, Freddie Mac, or other future AAA providers. Second, without a guarantee, investors will be required to conduct due diligence on the varied underwriting and origination practices of Members that sell loans for securitization. Finally, the Participating FHLBanks believe that there is currently a relatively small investor appetite for mortgage-backed securities sold without external enhancement. While external enhancement has historically been available from sureties and "wrap" providers, those alternatives are currently unavailable in today's market. As a public policy matter, the FHLBanks may be able to play a role in re-starting the secondary housing market that does not directly use government monies. The Participating FHLBanks also recognize that they cannot directly compete with government guarantees.

Ideally, to get preferred execution, the Participating FHLBanks would propose that the guaranty of securitized debt issued by the Office of Finance be modeled on the guaranty arrangements currently applicable to consolidated obligations ("COs"). The guarantee would be secured by the securitized assets and only cover losses in excess of any loss retention held by Members or covered by other enhancement. Each FHLBank would be compensated by the issuing FHLBank for the guarantee. Although far less efficient, one or more FHLBanks through the new office or Office of Finance could issue a guarantee of the securitized debt subordinate to the COs, but senior to each participating FHLBank's deposits, letters of credit, and stock.

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[15] If the Office of Finance is utilized, since board or directors representation is limited to only two of the FHLBanks' presidents, this governing structure for AMA securitization may need to be revisited. An effective governance structure should reflect the Members' ownership in the participating FHLBanks.

B. Existing Credit Enhancement Arrangements under MPP

The Master Commitment Contracts entered into between Members and FHLBanks participating in MPP establish the terms under which Members provide credit enhancement for loans sold by that Member. More specifically, the commitments establish a Lender Risk Account ("LRA"), and provide for supplemental mortgage insurance ("SMI") premiums to be paid by the FHLBank on behalf of the Member. Securitization of loans acquired by an FHLBank under MPP could entail modifications to these credit enhancement arrangements.

Although Participating FHLBanks have no immediate plans to securitize AMA acquired under MPP, securitization of existing AMA could be viable. For instance, under one approach, all SMI providers would terminate coverage under agreements negotiated with the applicable FHLBank. In connection with the negotiated termination, the FHLBank would take an assignment of all the rights of the SMI provider to withdraw amounts from the LRA. The FHLBank would allow the existing LRA arrangements to remain intact with each Member that sold loans securitized by the FHLBank. The LRA would function as originally contemplated, except the FHLBank (rather than the SMI provider) would withdraw amounts in respect to losses on the securitized loans. Because the LRA would remain a contractual relationship solely between the FHLBank and the Member, both the funding of the LRA by the FHLBank and withdrawals or releases from the LRA would not affect the cash flows entitlements of securitization investors. As such, the Member would preserve the benefit of its bargain (*i.e.*, releases from the LRA if its loans did not generate losses that consumed the entire LRA). The FHLBank, on the other hand, would be reimbursed (to the extent of amounts available under the LRA) for losses on securitized pools on which it had guaranteed the related securitized debt and would assume the administrative LRA withdrawal function currently performed by the SMI provider. A similar structure could be created to reduce SMI exposure for MPF® assets if desired.

With respect to new production, apart from securitization, MPP must rely too much on SMI insurance. Given the current lowered insurance strength ratings of the SMI providers, the credit protection provided is not cost-justified, and the claims paying exposure to the monoline providers is too highly concentrated. With or without securitization, this must be remedied in future AMA rule-makings.

C. Benefits to the FHLBanks

Securitization is a fundamental balance sheet and risk management tool for financial institutions and would provide the FHLBanks with an additional tool to manage the risks of these AMA programs by allowing them to package and sell the loans that they purchase from participating Members. The ability to securitize new originations and/or on-balance sheet mortgages will ensure that the FHLBanks can continue to offer their Members an outlet for mortgage loan sales even when holding mortgages on-balance sheet is an unattractive option. The FHLBanks should have the option to either securitize new originations or retain these loans and the associated risks on-balance sheet.

D. Capital Requirements

Under the AMA Regulation, each FHLBank is generally required to hold retained earnings plus general allowance for losses as support for the credit risk of all AMA estimated by the FHLBank to represent a credit risk that is greater than that of comparable instruments that have received the second highest credit rating from an NRSRO in an amount equal to or greater than the outstanding balance of the assets or pools of assets times a factor associated with the putative credit rating.[16] Each FHLBank is required to recalculate the estimated credit rating of a pool of AMA if there is evidence that a decline in the credit quality of that pool may have occurred.

The capital requirement is equal to the sum of the credit risk, market risk, and operational risk components of capital charges for all assets, off-balance sheet items, and derivative contracts. This credit risk component is computed based on the long-term ratings of the underlying collateral. Currently, because AMA loans are credit enhanced to an AA-equivalent rating, the capital requirement is equal to 0.60% of the outstanding loan balances. If the SMI remains in effect when the loans are securitized, the FHLBanks will continue to be exposed to catastrophic losses above the AA-equivalent credit enhancement by virtue of the contemplated guaranty. Thus, a securitization program will not change the credit risk exposure and the FHLBanks will have to maintain capital equal to 0.60% against the amount of on-balance sheet loans and outstanding securitized balances. If the SMI is eliminated and not replaced with other enhancement, the FHLBanks would be exposed to losses above the BBB-equivalent threshold and would be required to maintain capital in accordance with the FHLBanks' capital requirements (12 C.F.R. Part 932) of outstanding securitized balances.

The market risk component is computed based on the difference between an FHLBank's base case market value of equity and the market value of equity in a worst-case scenario. Applied in the context of securitization, this component will be computed based on assets and hedges (if any) in the securitization pipeline. Assuming that the market value changes within the pipeline are neutralized by hedging activity, securitization will allow the FHLBanks to acquire mortgage loans from their Members with very little market risk to the FHLBanks because the FHLBanks will be exposed to market risk only while the loans are in the securitization pipeline, whereas the FHLBanks would be exposed to market risk for many years if they were to keep those mortgage loans on their balance sheet.

The operating risk component is computed by taking 30% of the total of the market and credit risk components. Since the purchased loans (excluding the LRA or residual tails) would be off balance sheet, the leverage capital requirement is zero. Therefore risked-based capital, plus 30% operating risk factor, results in a .78% capital charge on the unpaid principal loan balances. The capital rules should be structured so as to not inadvertently create a double capital charge for the LRA or other residuals held on-balance sheet.

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[16] 12 C.F.R. § 955.6.

The current risk-based capital regulation applicable to FHLBanks (unlike commercial banks) does not reduce capital requirements for loan loss reserves. The Participating FHLBanks believe that capital requirements should be adjusted for the loan loss reserves established against AMA loans (assuming elimination or significant reduction of SMI). As noted above, assuming FHLBanks guarantee the securitized debt, securitization does not change the credit risk exposure to the FHLBank. Accordingly, the FHLBanks will have to maintain loan loss reserves against on-balance sheet loans and the amount of outstanding securitized balances. When risk-based capital rules are revised, Participating FHLBanks believe appropriate credit should be made for loan loss reserves on outstanding securitized balances. [17]

In summary, securitization will allow the FHLBanks to move the loans and the associated interest rate risk off the balance sheet and thereby decrease the market value risk component when compared to keeping these mortgage loans on the FHLBanks' balance sheets. If a System guarantee is provided, the exposure to credit losses will continue to exist under the securitization program at levels similar to credit risk under current programs.

E. Capabilities

Currently, most FHLBanks with AMA programs have the experience to manage home loans in portfolio. The same risk management skills apply to hedging a mortgage loan being inventoried in a securitization pipeline. However, before any of the FHLBanks are allowed to start a securitization program, they will need to demonstrate, as part of a new business activity filing, an understanding of the risks in this area and an ability to manage and mitigate those risks. Alternatively, one or more FHLBanks could use a joint office, another FHLBank, or a third-party provider to assist with the risk management function.

F. Accounting

Accounting considerations are an important factor in developing a securitization program and each FHLBank will need to have proper standards, systems, processes, and controls in place prior to implementing a securitization program.

Accounting rules for the transfer of financial assets and consolidation of an entity are currently subject to change. On September 15, 2008, the FASB issued an exposure draft of a proposed statement of financial accounting standards - Amendments to FASB Interpretation No. 46(R) - and an exposure draft of a proposed statement of financial accounting standards, Accounting for Transfer of Financial Assets, an amendment of SFAS Statement No. 140. The proposed amendments to SFAS 140 would eliminate qualifying special purpose entities ("QSPEs"). Additionally, the amendments to FIN 46R would replace the current consolidation model with a qualitative evaluation that requires consolidation of an entity when the reporting enterprise both

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[17] Insured depository institutions can count their loan loss allowance up to 1.25% of risk-weighted assets as Tier 2 capital. As the capital rules are updated, the FHLBanks should not be disadvantaged in the marketplace.

(a) has the power to direct matters which significantly impact the activities and success of the entity, and (b) has exposure to benefits and/or losses that could potentially be significant to the entity. If an enterprise is not able to reach a conclusion through the qualitative analysis, it would then proceed to a quantitative evaluation. The proposed statements would be effective for new transfers of financial assets and to all variable interest entities on or after January 1, 2010.

While there remain a number of unknowns regarding the changes to the FASB accounting rules described above, the Participating FHLBanks would not expect these proposed changes or the existing rules to prohibit or render uneconomic the development of a securitization program. Participating FHLBanks have developed, or will develop, the internal expertise required to make the attendant accounting determinations in accordance with generally accepted accounting principles.

G. Legal Changes to Existing Authority

To the extent required, the Participating FHLBanks would request that the FHFA undertake rulemaking to amend or supplement the existing AMA Regulation. This rulemaking should provide clear authorization for a securitization program by the FHLBanks, as well as the ability for one, some, or all of the FHLBanks to voluntarily provide a guarantee. While the rulemaking would provide general requirements for such a program, it should allow a high degree of flexibility to encourage innovation and evolution. FHLBanks seeking to participate in a securitization program would submit a new business activity notice to the FHFA. This would enable the FHFA to undertake a complete review of the FHLBank's preparedness before approving its participation in a securitization program.

H. Use of Structured Finance Mechanics by the FHLBanks

(i) General Transaction Structure

As the FHFA is aware, there is a high degree of diversity in the uses of structured finance vehicles in secondary mortgage market activities, and the following factual description is not intended in any respect to suggest that a structured finance variation of a whole-loan AMA sales transaction must be structured in this or any other particular manner. Nevertheless, purely for contextual purposes and solely to facilitate the FHFA's understanding of the ensuing legal discussion, we have set forth below one possible transactional variant for the structured sale by a Member of AMA to an FHLBank.

This structure would entail the organization by an FHLBank of a qualifying bankruptcy-remote special purpose entity ("SPE") that would acquire whole-loan AMA and then issue certificates backed by or representing interests in those loans. Although an SPE formed by a Member may be another common approach, the following discussion illustrates another alternative entailing the formation of an SPE by the FHLBank. The specific terms and conditions of a specific transaction, of course, would be developed on a transaction-by-transaction basis.

Under this alternative type of structured AMA transaction, a Member would sell eligible whole loans to the FHLBank or to a bankruptcy-remote special purpose subsidiary established by the Member (the "Depositor"). The Depositor, or the FHLBank, as the case may be, would deposit whole-loan AMA into the SPE established by the FHLBank. All of the whole loan AMA may be transferred by the Depositor, or the FHLBank, as the case may be, to the SPE in a single transaction, or the Depositor may transfer the loans to the SPE over a period of time. In any event, these transfers to the SPE would be funded in a manner that would be consistent with FHFA requirements. In return for whole-loan AMA transferred to it, the SPE would issue to the Depositor at least two classes of permanent pass-through certificates (the "Certificates") backed by the pool of whole-loan AMA and evidencing an interest in the underlying assets. The different classes of Certificates would include subordinated securities ("Junior Certificates") and the senior, investment grade securities (the "Senior Certificates").

The Certificates would be exempt from registration under the Securities Act of 1933.[18] The Senior Certificates would have an investment grade rating from a nationally recognized statistical rating organization ("NRSRO") and qualify as AMA. The FHLBank would initially purchase the Senior Certificates and the Depositor would retain the Junior Certificates. The Junior Certificates would represent the Member's credit support obligation as required by the AMA Regulation. The FHLBank may either retain or sell the Senior Certificates, and the Depositor may either retain or sell the Junior Certificates.

The SPE would be either a limited liability company ("LLC"), a business trust or a common law trust ("trust") established under applicable state law. In cases where the FHLBank establishes the SPE, it would not hold a controlling interest in the SPE (*i.e.*, more than 50% of the voting securities or similar controlling interest issued by the SPE). If the SPE was a trust, an unaffiliated third party would act as trustee pursuant to the terms of a trust agreement. The trust may be established based on the FHLBanks' trust powers, as discussed below. The FHLBank may or may not act as the servicer for the underlying loans held by the SPE.

(ii) AMA Regulation

The AMA Regulation permits a Member to establish a special purpose entity, transfer AMA-eligible whole loans to the SPE, and have the SPE issue certificates backed by the whole loans. The FHFB's 2002 approval of the FHLBank of Chicago's MPF Shared Funding® Program acknowledged the authority of Members to establish SPEs and the authority of FHLBanks, under the AMA Regulation, to acquire mortgage-backed certificates issued by a Member-sponsored SPE .[19] The AMA Regulation, however, does not expressly address the ability of an FHLBank

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[18] This treatment would be consistent with the exemption provided to other FHLBank securities, such as letters of credit, and the exemption from registration of mortgage-backed securities issued by Fannie Mae and Freddie Mac.

[19] Approval of New Business Activity Notice, 2002 APP-07 (Dec. 4, 2002).

itself to establish an SPE and issue certificates backed by or representing interests in the whole loans.[20]

(iii) Suggested Clarification to the AMA Regulation

The Participating FHLBanks believe that it would be beneficial for the FHFA to expressly clarify that the FHLBanks may employ structured finance tools and mechanisms to more effectively manage and disperse their credit exposures. This flexibility would permit the Member to transfer assets not only to a special purpose vehicle created by the Member rather than to the FHLBank directly, but also would allow an FHLBank to create a structural mechanism for multiple Members to sell AMA into one SPE in a cost-effective manner. If the FHLBanks have additional options when managing AMA-qualified assets, it will be easier for them to manage the credit and other risks associated with AMA. Although the AMA regulation does not expressly speak to these structured transaction variations, as discussed the Participating FHLBanks believe that transactions such as these are permissible under the incidental powers provisions of Section 11(a) of the FHLBank Act.[21]

I. Government Corporations Control Act

The Participating FHLBanks do not believe the Government Corporations Control Act ("GCCA") would prevent the FHLBanks from utilizing a special purpose entity or trust to facilitate structured finance transactions involving AMA. The GCCA provides that a government "agency may establish or acquire a corporation to act as an agency only by or under a law of the United States specifically authorizing the action."[22] This provision applies only if each element of a four-part test is satisfied. The four elements of the test are: (1) the "establishing entity" must be an agency, (2) it must establish or acquire the new entity, (3) the new entity must be a corporation, and (4) the new entity must "act as an agency." In turn, if at least one of the four elements of Section 9102 is shown to not apply to an SPE established by an FHLBank, the GCCA would not apply and the SPE could be established by an FHLBank even without a law specifically authorizing it. The Participating FHLBanks do not believe that all four elements apply and, therefore, the GCCA should not prevent the FHLBank from utilizing an SPE to facilitate structured finance transactions involving AMA. The GCCA analysis below is configured to address concerns about the creation of SPEs by the FHLBanks.

(i) The FHLBank is a GCCA "Agency"

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[20] This point was confirmed in the Supplementary Information contained in the Proposed AMA Regulation; although this acknowledged that a Member may use an SPE to issue AMA-qualified interests, it is silent regarding the ability of an FHLBank (as contrasted to a Member) to use a similar structure. 68 Fed. Reg. 39027, 39031 (2003).

[21] 12 U.S.C. § 1431(a).

[22] 31 U.S.C. § 9102.

It is reasonable to assume that the FHLBanks are "agencies" for purposes of the GCCA. Under the GCCA, the FHLBanks are "mixed-ownership Government corporations" and are covered by the GCCA's reporting and other requirements.[23] Therefore, this part of the test is satisfied.

(ii) The FHLBank Establishes the SPE

Solely for purposes of this discussion, we assume that the FHLBank "establishes" the SPE, even though (as noted below) the FHLBank will not control the entity. The Participating FHLBanks note, however, that there are numerous structured finance mechanisms available in the marketplace, not all of which necessarily would require or cause an FHLBank to "establish" an entity within the meaning of the GCCA.

(iii) The SPE Would Not Be a GCCA "Corporation"

The third element bars an agency from creating a non-federally-chartered (*i.e.*, a state-chartered) "corporation" that would act as an agency. If the SPE is established as an entity other than a corporation, according to the express language of the statute, the GCCA prohibition will not apply. The existing precedent establishes that the GCCA should be applied according to its plain meaning, and that the GCCA's prohibitions should be limited to a federal agency's establishment of a legal entity in the form of a corporation. Because, in many structured finance transactions – including those that an FHLBank may use in acquiring structured AMA – other legal entities, such as a limited liability company ("LLC") or a trust, may be used, we believe that the GCCA's prohibitions would not be applicable to those types of legal entities.

Although it is unclear whether an LLC would be considered a "corporation" under the GCCA, the federal banking agencies have permitted banks to exercise their authorized powers through investment and participation in LLCs.[24] Similarly, at least one other federal agency, the Federal Election Commission, has distinguished an LLC from a "corporation" under its governing statute.[25] Several legal differences between LLCs and corporations serve to distinguish the two, supporting the conclusion that an LLC should not be considered a "corporation" under the GCCA. These distinctions include their corporate governance, treatment for tax purposes, and ownership structure.

In addition, however, an SPE organized by an FHLBank as an LLC will not engage in substantive business operations or activities of any type; it will act as a purely passive entity that will do nothing other than acquire whole loan AMA and issue certificates representing interests

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[23] 31 U.S.C. § 9101(2).

[24] The OCC, for example, permits national banks to engage in permissible activities through the use of an LLC, given adherence to specific conditions. 12 C.F.R. § 5.34(e)(2).

[25] *See, e.g.*, FEC Advisory Opinion 1998-15 (Sept. 3, 1998); FEC Advisory Opinion 1997-17 (Sept. 19, 1997); FEC Advisory Opinion 1997-4 (April 25, 1997); FEC Advisory Opinion 1996-13 (June 10, 1996); FEC Advisory Opinion 1995-11 (Apr. 27, 1995).

in the AMA. The SPE's assets will not be actively managed, nor will the SPE engage in any other activities. Accordingly, an SPE organized by an FHLBank as an LLC is not engaging in any activities or functions that violate either the letter (see below) or the spirit of the GCCA.

In the case of a common law or business trust, we believe that such entities plainly should not be treated as "corporations" under the GCCA. A trust is very different in form and operation from a corporation (among other things, a trust has no Board of Directors, no Articles or Bylaws, and no management). An FHLBank has broad trust powers.[26] In addition, for the reasons noted with respect to LLCs in the previous paragraphs, any trust used in a structured AMA transaction will not engage in substantive business activities of the sort conducted by a corporation. Indeed, the FHFB had previously agreed with the FHLBanks that under the FHLBank Act incidental powers provisions,[27] FHLBanks can establish trusts.[28] The Memorandum to the FHFB notes that an FHLBank may irrevocably transfer property to a trust for the purpose of retiring debt. Additionally, other FHLBanks have previously established rabbi trusts under the incidental powers provisions to fund compensation and retirement benefits under a benefit equalization plan. Significantly, the Memorandum to the FHFB does not even raise or discuss any issues regarding the permissibility of establishing a trust under the GCCA.

Therefore, establishment of an LLC or trust by an FHLBank to facilitate structured finance transactions involving AMA would be permissible under the GCCA, because an LLC or a trust is not a corporation, and this third element of Section 9102 of the GCCA will not be satisfied.

(iv) The SPE Would Not "Act" as a GCCA "Agency"

Even if the SPE established was treated as a GCCA "corporation," Section 9102 would still be inapplicable because the fourth and final element of Section 9102 will not be satisfied, in that the SPE would not function or "act as an agency." Whether an entity is acting as an "agency" under the GCCA is based on certain factors. These factors vary depending on the specific analysis, but tend to fall into three broad categories: the extent of a federal agency's control of the entity, the source(s) of financing for the entity, and the purpose and functions of the entity.[29] There are several critical distinguishing characteristics between an SPE in the present situation and a subsidiary corporation "acting" as a GCCA "agency." Among other things: the FHLBank will not make any direct capital contribution to the SPE and will hold no voting equity in the SPE; the trustee (if a trust) or managing member (if an LLC) of the SPE will be an independent third party and not the FHLBank; no representatives of the FHLBank will be or act as directors, officers,

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26 12 C.F.R. § 977.3.

27 *See, e.g.*, 12 U.S.C. § 1431(a), 1432(a).

28 *See* Memorandum to Board of Directors of Federal Housing Finance Board (Aug. 21, 1992).

29 *See, e.g.*, Memorandum to Paul J. Drolet, General Counsel of the Federal Housing Finance Board (Dec. 5, 1995) ("1995 Memorandum") (concluding that a foundation established by an FHLBank was an agency); *Varicom Intern. v. OPM*, 934 F.Supp. 440 (D. D.C. 1996) (examining whether an entity is "acting as an agency" under the GCCA); *Motor Coach Industries, Inc. v. Dole*, 725 F.2d 958 (4th Cir. 1984) (examining whether a trust is an "agency" but not under the GCCA).

general partners, managing officials, or trustees of the SPE; and the FHLBank will not control the day-to-day activities of the SPE. Also, under prevailing federal banking law concepts of corporate organizational affiliation, the SPE would not be considered an "affiliate" of the FHLBank.[30] Finally, the SPE's financial statements will be independent of, and not consolidated, with the FHLBank under GAAP. In sum, in contrast to entities that have been determined to be agencies under the GCCA because they are capitalized and controlled by the agencies that establish them, the SPE in question would lack many of the core attributes of a federal agency subsidiary corporation that is "acting as an agency" under the GCCA.

Moreover, as previously noted, the activities of the SPE will be passive, and the SPE will not engage in any substantive business activities. In turn, this means that the SPE will not be participating in any policy-making or implementation activities of a typical "agency." By virtue of the fact that the SPE will not be actively engaged in the formulation or implementation of System objectives, but will merely be a passive conduit for the lawful purchase by the FHLBank of AMA, the essential characteristics of a corporation that is "acting as an agency" are lacking in the SPE to be established by the FHLBank.

The Participating FHLBanks further note that the FHFA's predecessor has previously permitted FHLBanks to undertake similarly structured activities without raising any questions under the GCCA. In a 1999 Opinion of the Office of the General Counsel, the FHFB permitted an FHLBank under the incidental powers provisions of FHLBank Act Section 11(a) to acquire mortgage loans, pool them, divide the pools into tranches, and sell the tranches to members and eligible non-member borrowers.[31] In that Opinion, the FHFB did not discuss the mechanism used by the FHLBank to pool and divide the loans but did state that "the FHLBank may be permitted to sell the tranches . . . regardless of the precise form of the transaction." The activities anticipated here are very similar to those described in that Opinion, except that here it is explicit that an SPE will be used, and that Members will also sell loans directly to the SPE. It is noteworthy that the FHFB did not discuss the GCCA in that Opinion, although it noted that the form of the transaction may require "expansion or modification" of the Opinion.

In conclusion, it would be difficult to conclude that an SPE established by an FHLBank, especially those created as LLCs or trusts, would be "acting as an agency" under the GCCA. In turn, we conclude that the establishment of such an entity is permissible under the GCCA as certainly one, and in almost all cases two, of the four elements required for the GCCA provisions to apply will not be satisfied. The Participating FHLBanks, therefore, do not believe that the GCCA prohibits an FHLBank from establishing an SPE to facilitate structured finance transactions involving AMA.

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[30] In the 1995 Memorandum, the FHFB used the definition of "affiliate" under the National Bank Act (12 U.S.C. § 221a(b)(1)) as an analogy, to note the "special relationship" between the entity in question and the FHLBank. This relationship was used as a factor in determining that the entity was an agency. *See* 1995 Memorandum, n. 2.

[31] *See* Federal Housing Finance Board, Opinion of the Office of General Counsel, August 12, 1999.

J. Tax/REMIC Considerations

The Concept Release specifically asks if any other laws would create obstacles to an FHLBank securitization program and cites potential tax considerations. In general, if the FHLBanks were to issue CMOs as part of the securitization program, the FHLBanks would want such interests to qualify for the tax treatment provided to REMICs. There should be no insurmountable tax law obstacle to obtaining this desired treatment, although the FHLBanks may need to address certain issues.[32]

The primary reason to make use of the REMIC regime is to avoid imposition of an entity level tax on the net collateral income produced in a CMO securitization. Absent REMIC treatment, such a tax generally would be imposed pursuant to the taxable mortgage pool ("TMP") rules under 26 U.S.C. § 7701(i).[33] However, in certain circumstances, a mortgage securitization may be structured to avoid the punitive application of the TMP rules without also having to qualify as a REMIC. These circumstances may include those where the securitization does not issue time or credit-tranched securities, the securitization involves only certain types of nonperforming distressed mortgage loan collateral, or the securitization serves solely to liquidate a pool of nonperforming mortgage collateral. Each particular situation would need to be examined to evaluate whether a REMIC structure best serves the proposed securitization.

IV. Conclusion

The Participating FHLBanks look forward to continuing their work with the FHFA on the existing AMA programs and the development of AMA securitization programs. We hope that the above provided information is useful in your analysis and the preparation of your report to Congress.

To summarize our comments for consideration by the FHFA, the benefits of securitizations of AMA assets far exceed the risks. Securitization (the sale of AMA with or without guarantees provided by one or more FHLBanks) is a needed risk mitigation tool and will help further the FHLBanks' mission to provide funding for housing finance. Many Members routinely originate and then sell high-quality, conforming home loans. To ensure they have reliable, low-cost mortgage funding, they need competitive secondary market access, which the FHLBanks may

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[32] For example, because an FHLBank is not subject to federal income tax it should most likely be considered a "disqualified organization" under certain REMIC tax provisions and therefore could not hold most or many REMIC residual interests that might be created in a CMO REMIC securitization. 26 U.S.C. § 860E. This restriction should not be problematic in practice, however, since (i) a robust secondary market comprised of sophisticated financial institutions exists to acquire and hold these special tax-related REMIC securities, and (ii) in most modern REMIC structures, the REMIC residual interest is a noneconomic interest, and thus disposing of it does not typically involve a disposition of much, if any, of the economic value underlying the securitization.

[33] In general, for federal income tax purposes, an entity or a portion of an entity (including a collateral pool of mortgage assets) will be treated as a separate taxable C corporation which may not be consolidated for tax purposes with any other corporation if such entity (or portion thereof) meets certain real estate mortgage asset thresholds and conditions, and issues multiple classes of debt backed by such assets.

provide. The need for new secondary market participants has never been greater. Once the credit crisis and the level of government credit support abate, the FHLBanks may assist in transitioning private capital investors back into the secondary market.

Thank you for the opportunity to comment on the Concept Release. We and the Participating FHLBanks look forward to seeing your report to Congress on this important topic. If you have any questions or need additional information, please contact Paul Jorissen (212 506-2555), Jeff Taft (202 263-3293), Jonathan West (317 465-0515), General Counsel of the FHLBank of Indianapolis, or Andy Howell (513 852-7526), Executive Vice President and Chief Operating Officer of FHLBank of Cincinnati.

Sincerely,

Mayer Brown LLP

By: _____ By: _____
Paul Jorissen Jeffrey Taft