FHLB Chicago
Federal Home Loan Bank of Chicago

April 28, 2009

VIA E-MAIL – RegComments@FHFA.gov

Mr. Alfred M. Pollard
General Counsel
Mr. Christopher T. Curtis
Sr. Deputy General Counsel and Managing Counsel
Federal Housing Finance Agency
Fourth Floor
1700 G Street, N.W.
Washington, D.C. 20552

Re: Securitization Study Comment Letter

Dear Messrs. Pollard and Curtis:

The Federal Home Loan Bank of Chicago, joined by the Federal Home Loan Banks of Des Moines, Topeka and Pittsburgh, appreciates the opportunity to submit this letter in response to the request of the Federal Housing Finance Agency ("FHFA") for public comment in its Notice of Concept Release[1], published February 27, 2009. In preparation for a report to Congress mandated by the Housing and Economic Recovery Act of 2008, the FHFA has invited comment on a number of questions related to the securitization of Acquired Member Assets ("AMA") by the Federal Home Loan Banks ("FHLBs").

I. Introductory Comments and Background

The FHLBs mission of promoting housing finance has traditionally been accomplished through the advances business. The Mortgage Partnership Finance® ("MPF®") Program[2], described by a Federal District Court as the "functional equivalent" of advances[3], has furthered this mission through a unique risk sharing structure that results in a better mortgage financing structure for FHLB members and their home buying customers.

Since beginning in 1997, the MPF Program has demonstrated remarkable success and market acceptance. The number of participating financial institutions ("PFIs") has continued to grow steadily and now exceeds 1,109 member institutions in 39 states. These members have funded over $175 billion of mortgage loans, helping more than

[1] 74 Fed. Reg. 8955 (2009).

[2] "Mortgage Partnership Finance," "MPF" and "MPF Shared Funding" are registered trademarks, and "MPF Xtra" is a trademark, of the Federal Home Loan Bank of Chicago.

[3] *Texas Sav. & Community Bankers Ass'n v. Federal Housing Finance Board,* No. A 97 CA 421 SS, 1998 WL 842181 (W.D. Tex. June 25, 1998).

1.2 million American families in all 50 states, as well as the District of Columbia, Puerto Rico and the Virgin Islands, to buy a new house or lower the cost of their existing home through refinancing.

The MPF Program continues to be in strong demand as FHLB members of all sizes have found value in its risk-sharing structure. Large and mid-sized PFIs have used it to deliver their highest quality mortgage loans and also as leverage to negotiate better pricing from Fannie Mae and Freddie Mac (the "Agencies"). For smaller PFIs, many of which have been effectively shut out of the secondary market, the MPF Program has often been the only way they can offer long-term, fixed-rate mortgages to consumers within their communities.

The key to the MPF Program's success has been its risk sharing structure that creates a partnership between the FHLBs and the PFIs. Each party manages the risks it is best suited to manage. Because PFIs, which are predominately community banks, know their customers better than any secondary market entity can, they are required[4] to provide credit enhancement on the pool of MPF loans they sell or fund through the Program. In so doing, PFIs effectively are responsible for the primary credit risk of their loans. The FHLBs provide the funding for the loans and, to date, have retained them on their balance sheets, managing the interest rate and prepayment risks.

This structure purposely requires the PFIs to retain most of the credit risk of the mortgages they underwrite. Therefore, they have no incentive to create exotic loans with exploding interest rates or negative amortizing features. There is little temptation to underwrite mortgages with no documentation of the borrower's income or ability to repay the loan. Quite the opposite. Community bankers value the customer relationship that comes with making a mortgage and work hard to ensure their customers receive a mortgage loan appropriate for their financial situation.

Because PFIs are required to have "skin in the game," it should be no surprise that MPF loans have exhibited superior credit performance since the Program began almost twelve years ago. The amount of loan delinquencies, foreclosures and credit losses for MPF loans always have been well below the national average. This is especially true today during the current mortgage crisis.

For example, as of March 31st, only 0.68% of MPF conventional loans were 90 days or more delinquent (a key measure of credit performance) compared to the national average for conventional loans of 2.25%[5], or less than one-third the national average. The number of MPF conventional loans in foreclosure were 0.24%, which is less than one-quarter the national average of 1.05%.

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[4] With the exception of the MPF Xtra™ product under which the Chicago Bank concurrently sells the loans it buys from PFIs to Fannie Mae with no credit enhancement provided by PFIs.

[5] Data on 1- to 4-Unit Prime Fixed-Rate Mortgages (not seasonally adjusted) from the MBA National Delinquency Survey, as of Dec. 31, 2008.

A similar picture can be seen by looking at the number of loans with a credit loss. Of the 944,475 conventional loans have been funded since the Program began, with only 1,141 loans, or 0.12%, have experienced a credit loss[6]. The dollar amount of these losses has amounted to only $12.2 million, or 0.0069% of the total MPF Program fundings of approximately $175 billion. These figures convincingly demonstrate the value of a mortgage structure that requires lenders to keep "skin in the game" by retaining the principal credit risk.

Managing the interest rate risks of the MPF loans held in portfolio has been more challenging for the FHLBs. To date, all MPF loans have been long-term, fixed-rate mortgages. Properly matching the duration of these assets with the liabilities that funded them can be difficult given the propensity for the loans to prepay when interest rates fall. The FHLBs have used a variety of risk management tools to <u>indirectly</u> transfer the interest rate and prepayment risks of MPF assets to third parties. Examples include using fixed-rate Consolidated Obligation ("CO") bonds and callable CO bonds when funding the loans, as well as using derivative products such as swaps, options, swaptions, caps and floors.

From the earliest days of the MPF Program's conception, an AMA securitization program was contemplated and expected. Given the balance sheet constraints of the FHLBs, it was obvious that a method would be needed to move the loans off of the FHLB balance sheets in order to create capacity for new loans. Securitization involves a <u>direct</u> transfer of assets off the balance sheet and therefore is more efficient than the alternative methods the FHLBs have used to date. Adding a securitization option would be a significant risk management tool for the FHLBs, and would also provide an additional source of liquidity.

A securitization program is a natural and evolutionary progression for the MPF Program. It would remove any constraints on FHLB members to use the MPF Program to fund mortgage loans for their customers and would allow the FHLBs to more efficiently transfer the interest rate risks of the loans to third parties. With such a program, the FHLBs would have a more complete range of risk management tools to manage their AMA programs, allowing them to better match their assets to their liabilities.

In 2002, the MPF Shared Funding® Program successfully demonstrated how MPF-eligible loans could be structured into mortgage backed certificates as attractive high quality investments for FHLB members. Two transactions were completed, creating a total of $1 billion of securities. For each transaction, a subordinate tranche of the securities was placed with a PFI as an investment, while the FHLBs retained the senior tranche of the securities. The structure of the MPF Shared Funding program differed from an Agency securitization in three important respects: (1) the securities were not

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[6] Government mortgages guaranteed by the FHA and HUD (Sec. 184), and government mortgages insured by the VA and RHS (Sec. 502), have also been delivered under the MPF Program. Due to their Federal backing, these loans have experienced no credit losses.

guaranteed by the FHLBs; (2) they were not offered publicly, but were privately placed with the FHLBs and PFIs; and (3) they were rated by Standard and Poor's.

A securitization program that included an FHLB guarantee is likely to result in a better price for the securities, creating a more efficient, viable program. From an investors' viewpoint, a FHLB guarantee on AMA securities, backed by the PFIs' credit enhancement, should increase the value of mortgages that are securitized by reducing the FHLBs' credit risk and providing a strong incentive for high quality underwriting. A program that unites the intrinsic core competencies of FHLB members to manage the credit risk of their customers with the risk transfer benefits of securitization should produce a superior financing structure that benefits FHLB members and American homebuyers.

In summary, an AMA securitization program would:

- **Strengthen the safety and soundness of the FHLB System, and decrease the risk to American taxpayers,** by creating a complementary risk management tool for the FHLBs to better manage the risks of their AMA programs;

- **Benefit American homebuyers by furthering the FHLB housing finance mission.** By increasing competition and efficiency in the secondary mortgage market to help drive down the costs of mortgage finance and enable more Americans to obtain a traditional, responsibly underwritten mortgage on terms affordable to them;

- **Satisfy FHLB member demand to sell mortgages in the secondary market while retaining the primary credit risk and valuable customer relationships of the loans they originate;**

- **Provide an additional source of liquidity for the FHLBs**, in addition to FHLB System COs;

- **Increase the value of FHLB membership** by offering members a new type of MBS with attractive risk characteristics to meet their asset-liability needs; and

II. RESPONSES TO QUESTIONS

The following are our responses to the list of questions in the FHFA's Concept Release.

A. Securitization of AMA

A.1. Should the [Federal Home Loan] Banks [("Bank(s)")] be authorized to securitize loans? If so, should the Banks be authorized to continue their existing AMA programs in addition to being authorized to securitize loans? Would a pass-

through program such as MPF Xtra provide a better alternative to a direct securitization program?

Response: Yes, the Banks should be authorized to securitize loans while continuing to offer existing MPF Program portfolio products, which could be both existing products as well as new products that have yet to be developed. An AMA securitization program would be a complementary risk management tool providing the Banks with the flexibility to acquire balance sheet assets when beneficial and providing members with secondary market access through securitization when beneficial. When economically viable, the Banks should be able to acquire MPF assets for their portfolios, subject to any size limitations imposed by the FHFA.

A securitization program would not eliminate the need for the MPF Xtra™ product, which would remain yet another alternative for Bank members and would be complementary to a securitization program. Having a full range of program options for FHLB members would allow the Banks to better control the nature of the assets acquired from PFIs and the process by which loans are acquired and serviced. The Banks could also better cover their costs of operating the MPF Program.

A.2. Should individual Banks be authorized to securitize loans or should the securitization be conducted by the Bank System as a whole?

Response: To achieve the best possible efficiencies, securitization should be conducted by the Bank System as a whole in a manner similar to how the Office of Finance ("OF") issues Consolidated Obligations ("COs"). It would make sense to consolidate the operational aspects of all AMA programs into this joint office, including operations related to both on-balance sheet and off-balance sheet assets. It should not be limited to new loan production, even though securitizing existing AMA assets would be unlikely given the economics of securitization.

A.3. Should any limitations be imposed on the Banks with respect to the mortgages purchased either under the AMA program as it currently exists or under a modified AMA program? If so, what types of limitations should be imposed?

Response: Portfolio limits for on-balance sheet AMA should be a multiple of capital in the same manner that the Banks' MBS investment is limited to a multiple of capital. Because securitized AMA would be off-balance sheet, the amount of securitized AMA should be essentially unlimited, subject only to risk-based capital requirements.

A.4. What are the ways that the master commitment obligations and participations between Banks can be unwound so that the existing AMA mortgages could be securitized and sold?

Response: Participations do not need to be unwound to securitize or sell AMA since all participants in any Master Commitment could jointly transfer 100% ownership in the AMA to the buyer. It may not be economically viable to settle outstanding credit enhancement obligations with PFIs and unwind existing Master Commitments in order to securitize existing AMA portfolios. The cost of securitization could be factored into future AMA acquisitions. Given the current interest rate environment, existing AMA portfolios have been prepaying rapidly, so there is little interest in securitizing existing AMA.

B. Credit Enhancement on MBS

B.1. If the Banks securitize mortgages, should they guarantee the resulting MBS?

Response: Yes, for AMA securities to meet market expectations with respect to agency guaranteed MBS, a Bank guarantee may be necessary to the success of the program. A non-guaranteed MBS program, using a senior-subordinated structure[7], may be possible given the low rate of credit losses on AMA assets to date, but would likely be less economical and efficient.

B.2. Given the Banks' joint and several liability for consolidated obligations, would it be reasonable for only a sub-set of the Banks to guarantee MBS?

Response: It is unclear how the market would price a guarantee from only one Bank or a sub-set of Banks. Individual Banks have the ability to issue their own debt (with regulatory approval), have stand-alone ratings, and effectively guarantee on their own member deposits, letters of credit, and derivative transactions. Robust risk-based capital guidelines and regulatory oversight would be critical to managing the risk of this guarantee.

However, to achieve the best execution and chances for success, the Bank System as a whole would need to guarantee the MBS. As with the current OF arrangement when issuing System COs, the Banks whose members deliver AMA could be considered primarily liable for the MBS issued with respect to the AMA they acquired and securitized.

B.3. If the Banks did not provide a guarantee, would other types of credit enhancement be economically viable or more efficient?

Response: The current environment is unique in the history of mortgage finance. Currently, a securitization program without a Bank guarantee is unlikely to be viable. But as cycles and markets change, the viability of alternative structures that do not rely on a Bank guarantee could become possible. Nonetheless, to achieve the best execution and chances for success, a Bank System guarantee is necessary.

[7] It might be possible to supplement the senior-subordinate structure of an MBS with credit enhancement provided by the Banks on a back-to-back basis in an amount equal to the PFIs' credit enhancement obligations under the underlying master commitments.

B.4. Would there be a viable market for MBS issued by the Banks or the Bank System?

Response: Yes, both investors in the agency-backed MBS and private label investors are potential investors in Bank System MBS. These groups include the Banks as well as the 8,100 Bank members.

B.5. How would the market in which these securities trade be affected by the level and type of credit enhancement?

Response: If AMA securities are guaranteed by the Bank System, the underlying credit enhancement provided by PFIs and mortgage insurers would not significantly impact the market for such securities, though the market should place some value on the incentives the AMA structure provides to PFIs to underwrite and service their loans prudently. The credit enhancement structure primarily benefits the Banks by significantly reducing their exposure to the credit risk of the mortgages they are guaranteeing.

B.6. Would these securities be likely to trade similarly to Private Label MBS or Agency MBS, and if so, how might such a program affect these markets? Alternatively, would such securities constitute a new market? How large would this program need to be to achieve a liquid market?

Response: Initially, Bank System AMA securities are likely to trade somewhere between Private Label MBS and Agency MBS. As broader market acceptance is gained, they should trade closer to Agency MBS. To be a programmatic issuer, we estimate the Bank System would need to issue at least $10 billion of MBS per year.

C. Benefits and Risks of Securitization

C.1. Would the Bank's securitization of mortgages provide added liquidity and competition to the housing finance market?

Response: Yes, an AMA securitization program would give the 8,100 Bank members a competitive and efficient new option for their mortgage lending, particularly for smaller Bank members, many of which rely sole on the Banks to provide quality mortgage lending in their communities. The increased competition and efficiency in the secondary market would help drive down the costs of mortgage finance, increasing affordability for all American consumer.

C.2. What are the benefits to Bank System members?

Response: Small and mid-sized members would benefit from competitive pricing derived from access to the secondary market. Bank System MBS would provide an important source of liquidity for these members. The Banks can manage the counterparty risk of dealing with our members more efficiently than Fannie Mae or Freddie Mac. By leveraging off our existing credit relationships with our members and the cooperative nature of the Bank System, the Banks can offer better prices to our members (assuming at least minimal market acceptance for Bank System MBS) and our members in turn can better serve their local housing markets.

C.3. Would the benefits be different for large and small members?

Response: All Bank members would benefit from the additional choice of a securitization program. As with the existing AMA programs, smaller members in particular would benefit from such a program because they lack direct access to the capital markets and the economies of scale to afford the best pricing from the secondary market Agencies.

C.4. How would this activity further the public purpose of the Banks and promote the cooperative nature of the System? How would it affect the availability and affordability of mortgage credit, especially for low- and moderate-income households and first time homebuyers?

Response: A securitization program that allows the Banks to more efficiently manage their AMA programs would be wholly consistent with, and would further, the Banks' housing finance mission. Every dollar of AMA, regardless of whether it is in the form of an MPF loan held in portfolio or in securitized form, helps American families buy new homes or lowers the cost of their existing homes through refinancing. A securitization program would make the AMA programs more viable.

As mentioned earlier, many smaller PFIs would be unable to offer traditional mortgages to consumers in their communities without the MPF Program. Having the ability to securitize loans would effectively eliminate the current balance sheet constraints of the MPF Program, allowing more PFIs to offer their homebuying customers a conforming-sized, responsibly underwritten mortgage, funded through the Program.

AMA securities would also increase the value of FHLB membership, strengthening the cooperative nature of the System, by offering members a new type of MBS with attractive risk characteristics to meet their investment needs.

Approximately 42.1% of total MPF loans funded since the Program began have been to low and moderate income homebuyers[8]. By increasing competition and efficiency in the secondary market, a securitization program also would help drive down the costs of mortgage finance, increasing the affordability of home buying for more low and moderate income families and first time buyers.

C.5. How could the Banks' joint and several liability be affected?

Response: If a Bank System guarantee of the MBS is provided, the Banks would be jointly and severally responsible should the underlying AMA and the credit

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[8] Defined as borrower's income below 115% of MSA median income.

enhancements prove insufficient to repay the MBS. This responsibility could be handled in a manner similar to the Banks' responsibility for COs. To the extent that any one of the Banks is considered the primary obligor for a particular MBS, it would be required to repay such difference on the MBS, though all the Banks would be legally obligated to cover such obligation should the primary obligor Bank be unable to do so. If the incremental exposure from guaranteeing the MBS is properly monitored, there should be no impact on CO issuance and joint and several liability[9].

C.6. What types of risk would the Banks face under a securitization program?

Response: The Banks would be exposed to similar risks as they currently face operating their AMA programs. An AMA securitization program is a risk management tool that would reduce the risks to which the Banks currently are exposed. Under a securitization program, the Banks would have exposure to credit risk with respect to the underlying AMA; credit risk with respect to PFIs, mortgage insurers and any other parties providing credit enhancement; servicing risk with respect to PFIs acting as Servicers of the AMA loans; modeling risk with respect to credit enhancement, pricing and prepayment speeds, market risk with respect to the market value of the mortgage loans while in the securitization pipeline prior to issuance of the MBS; and political risk from changes in laws, rules and regulations.

C.7. Do the Banks have the ability to manage these risks? What activities would the Banks need to undertake to mitigate and manage any such risks?

Response: Yes, the Banks could manage these risks in the same manner as they currently do, though hiring additional professional staff with securities experience would be likely.

Alternatively, a third party could be used to manage these risks, such as a joint office capitalized by the Banks that would hedge the pipeline, warehouse the loans and manage a trust that would issue securities backed by pooled AMA loans.

C.8. What prudential principles are needed and what prudential rules, limitations, and constraints would FHFA need impose on the Banks to ensure that securitization is conducted in a safe and sound manner?

Response: As described above, a key reason for the success of the MPF Program has been the risk sharing structure that requires PFIs to retain the primary credit risk of the mortgages they deliver into the Program. This has produced MPF loans with exceptionally high credit quality. Requiring lenders to keep some "skin in the game" by retaining the primary credit risk is a prudent principle worth retaining in an AMA securitization program.

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[9] Since AMA are deemed to be the functional equivalent of advances, the impact on joint and several liability is no different than the credit risk undertaken by the Banks with respect to advances.

Capital support for on-balance sheet AMA is another prudent requirement to consider. However, reliance on NRSRO models should be limited, while more reliance on other approved risk rating models should be allowed.

D. Capital Requirements

D.1. What, if any, changes to the current capital requirements may be necessary if the Banks were to undertake a securitization program?

Response: To the extent that the Banks' guarantee of AMA securities is not adequately offset by secured or appropriately rated credit enhancement, that exposure should be subject to tiered risk-based capital requirements tied to the level of risk.

D.2. Would the current rules need to be changed to account for credit or other risks associated with mortgage loan guarantees, if the Banks were to provide a guarantee, as part of the securitization program?

Response: Yes, it might be appropriate to consider allowing contingency reserves that might resemble those required under the Model Mortgage Guaranty Insurance Act to be counted as regulatory capital.

D.3. What are the risks related to mortgage loans and associated hedging instruments that would be in a securitization pipeline?

Response: The risks to a Bank related to an AMA securitization program are similar to, but markedly less than, the risks of holding fixed-rate AMA in portfolio until they prepay or mature, which can be as long as 30 years. Securitization is a risk management tool whose primary benefit is to allow a Bank to better manage its exposure to the market risk of the mortgage loans it purchases or funds.

D.4. How should the potential increased exposure to operational risk associated with a securitization program be captured by the risk based capital rules?

Response: The same methodology of risk based capital rules should apply to assets in a securitization pipeline as to all other assets held on-balance sheet. While the mortgage loans are held for several days or weeks on the books of a Bank, the risk based capital rules should apply, especially because the loans would be credit enhanced and qualify as AMA.

E. Financial Viability

E.1. What conditions, resources, and capabilities, including technological capabilities, would be necessary for the Banks to implement a viable securitization program?

Response: A structuring model that values the credit enhancement of the loans would be necessary to evaluate the loan characteristics and price the securities. Each Bank will need to ensure it has the necessary resources, human and technological, to manage a viable program. Preferably, a joint office could be used to provide the technological resources in order to have the economies of scale and scope necessary to keep costs at a reasonable level.

E.2. What are the key factors for launching and operating a successful securitization program in the foreseeable future? What scale of operations would be necessary to operate a successful securitization operation?

Response: The key factors for an AMA securitization program would be the same as the factors that were key to the successful launch and operation of the AMA programs originally. These include the retention of trained staff, technology capabilities, member support, regulatory support, and appropriate risk management structures.

For an AMA securitization program to be viable, we estimate the minimum amount of volume required to create an efficient and liquid market to be approximately $10 billion of securities per year.

E.3. Given the Banks' capabilities, what are the feasible strategic alternatives for competing in the securitization market?

Response: Possible securitization structures include MBS with a Bank System guarantee or a senior-subordinate structure, such as the MPF Shared Funding program used. The best and most efficient execution will come from the Bank guarantee structure given the market's preference for GSE backing. Having such a guarantee, combined with the credit enhancement provided by PFIs, should allow Bank System guaranteed securities to successfully compete with Agency MBS and private label MBS once the market became familiar with these assets.

E4. How might the Banks achieve a comparative advantage over existing competitors in the market?

Response: A significant comparative advantage of the Banks arises from the cooperative structure of the System. The Banks' unique and close relationship with their 8,100 member customers and shareholders provides them with a counterparty risk management process that is superior to all other MBS issuers in the market place today. The Banks are able to leverage their membership approval and their continuous credit monitoring and risk scoring practices to ensure they have adequate and sufficient credit controls and collateral in place with each member at all times. The Banks' have a superior lien position over their members' assets, as granted by regulation and as perfected through UCC filings. They also have the ability to monitor each member's financial condition through quarterly, monthly and daily reports requirements. All of these tools give the Banks a superior risk management process for minimizing credit risk and better ensuring timely payments for MBS investors.

E.5. What segment of the market for MBS would the Banks serve? How would the Banks differentiate their MBS product from existing competitors in that market? Would there be sufficient demand for product securitized by the Banks?

Response: AMA securities would compete primarily in the Agency MBS market, but would be differentiated by the superior underwriting capabilities of the PFIs and the credit enhancement they provide. These attributes translate into lower credit losses and more stable cash flow characteristics. Once market acceptance has been gained, the AMA securities should trade at a favorable price compared to Agency MBS.

E.6. Would the Banks be able to earn a sufficient return if the current structure of the AMA programs in which members provide the credit enhancement were carried over to the securitized products? Would a Bank guarantee of the mortgages be necessary to assure an adequate return for the Banks and/or the success of the program?

Response: MBS investors should find the credit enhancement feature of AMA securities very attractive. It should increase the value of the mortgages that are securitized, which should enhance the financial viability of AMA securities. The credit enhancement level could be varied so that the resulting securitized product is economically feasible for the originating PFI, the securitizing Bank or Banks, and the end investor.

As mentioned in the response above to question B.1., a Bank guarantee may be necessary to meet market expectations and would be preferred.

E.7. How would the Banks' advances programs (and returns from the advances business) be affected if the Banks also bought mortgages from members to securitize? Could a securitization program affect other Bank products, such as MPF Xtra?

Response: Assuming the Banks continued to acquire AMA for their portfolios along with advances while securitizing certain AMA, the fee income realized from securitization could balance the returns on those assets. We believe that the credit-risk sharing structure of the MPF Program properly rewards the PFIs and incents them to underwrite and service AMA prudently. The MPF risk sharing structure better serves Bank members and their customers than the traditional secondary market structures used by the Agencies and the MPF Xtra product, in which all credit risk is retained by the Agencies. Therefore, securitization of AMA is a better utilization of the Bank System's strengths and cooperative structure than merely growing the MPF Xtra channel.

E.8. How would the development of a market for covered bonds affect the feasibility of launching a securitization program?

Response: Small and medium sized PFIs would not make use of covered bonds due to the cost and complexity of developing a program to issue such bonds and therefore an AMA securitization program geared to small and medium members would allow these members to better compete with the large institutions that would likely issue covered bonds.

F. Accounting Issues

F.1. Would accounting considerations, including, but not limited to amendments to FIN 46(R) and FASB 140, present a major obstacle to the Banks' implementing a securitization program?

Response: Accounting considerations may or may not be a major obstacle for securitizing new mortgage originations depending on what amendments the FASB makes to the existing accounting standards under FIN 46(R) and FAS 140. For example, if the FASB eliminates the ability to achieve off-balance sheet financing accounting treatment through the use of a qualifying special purpose entity, it may result in consolidation of the special purpose entity by a Bank. The amendments to FIN 46(R) and FAS 140 are expected to be issued in the second quarter of 2009. The effective date was expected to be January 1, 2010; however, the effective date is no longer indicated on the FASB website. Additionally, depending on the level of credit enhancement provided by a PFI, there could be a question of whether a "true sale" has been made to a Bank. Of course, each Bank would need to ensure it has the proper standards, systems, processes and controls in place prior to implementation.

For AMA currently held in portfolio, the accounting considerations of a securitization program could be a significant impediment. However, as mentioned above, potential changes to FIN 46(R) and FAS 140 are under consideration that could have major implications for the securitization business.

Also, significant structural changes to the secondary mortgage market are under consideration by policymakers prompted by the conservatorship of Fannie Mae and Freddie Mac. If these entities are significantly restructured, it is likely that the accounting rules will need to be changed to implement and accommodate the new structure.

G. Legal Issues

G.1. Do the incidental authorities in section 11(a) and 11(e)(1) of the Bank Act provide a sufficient basis to authorize a securitization program, especially if the Banks are allowed to guarantee the securitized mortgages?

Response: Yes, Section 11(a) provides a sufficient basis to authorize a securitization program, along with the incidental authority of Section 12(a) of the Bank Act. If the Banks have the authority to acquire AMA and the authority to dispose of AMA, then securitization merely is a method of disposing of such assets that is incidental to owning them.

G.2. Are there other laws, such as the Government Corporation Control Act or specific tax provisions, which could create obstacles to a Bank securitization program?

Response: If the Banks guarantee the AMA securities, they would not need to establish a corporation to issue the securities. The use of a trust indenture similar to a Fannie Mae trust indenture would not be a corporation and therefore would not be subject to the limitations of the Government Corporation Control Act. With respect to tax laws such as those governing REMICs, the Banks would need to structure their securitizations to comply with such tax laws it they determined using a REMIC was beneficial or appropriate.

G.3. Given that different formats for securitization could be adopted by the Banks, would some formats present more legal obstacles to a program than others?

Response: Yes, and therefore the Banks would select structures to minimize obstacles such as creating back-to-back transfers of AMA to avoid transforming PFI credit enhancements into credit derivatives.

We appreciate your consideration of our views. If you have any questions, please contact Peter E. Gutzmer, Executive Vice President, General Counsel and Corporate Secretary at 312.565.5805 or pgutzmer@fhlbc.com.

Sincerely,

Matthew R. Feldman
President and CEO