October 5, 2009

Alfred M. Pollard, General Counsel
Federal Housing Finance Agency
1700 G Street, NW, 4th Floor
Washington, DC 20552
RegComments@fhfa.gov

Subject: Comments/HERA Section 1217 Study

Dear Mr. Pollard:

The undersigned Federal Home Loan Banks ("FHLBanks") have reviewed the FHFA's request for comment on the **HERA Section 1217** Study presented to Congress in July of this year and would like to take this opportunity to provide our observations on the Study and Advisory Bulletin 2008-AB-02 ("2008-AB-02").

I. Comment Summary

The FHLBanks share the widespread public concern about the risks inherent in nontraditional and subprime mortgage products and the role that the lending practices associated with these products has played in the current economic downturn. At the same time, we believe that the measures taken by the FHLBanks to respond to the advisory bulletins and other guidance issued by the former Federal Housing Finance Board provide a high level of assurance that the loans and securities used as collateral to support the FHLBank advances are consistent with the federal bank interagency guidance on nontraditional mortgage products.

In the context of today's marketplace, it is incumbent upon us to vet the potential unintended consequences of the restrictions being placed on an FHLBank's ability to accept both private-label mortgage-backed securities ("PLMBS") and certain acquired whole loans as collateral for advances.

In Section V of the HERA study, the FHFA announced its intent to clarify the restrictions on acceptance of PLMBS that are presented in 2008-AB-02 as follows:

> "The advisory bulletin states that residential mortgage loans underlying private-label MBS issued after July 10, 2007, must conform to the interagency guidance, but it is silent about MBS issued before that date that a member may acquire after that date. FHFA intends to clarify that MBS purchased by a member after July 10, 2007, is also subject to the guidance contained in Advisory Bulletin 2008-AB-02." (emphasis supplied)

We have some concerns with the above noted 2008-AB-02 clarification, both in regard to the timing of its implementation and the substance of its requirements. These are discussed below.

II. Specific Concerns

(1) **The requirement placed on the issuer of the security likely cannot be met** - The specific requirement contained in 2008-AB-02 states that for securities issued after July 10, 2007, (the "trigger date") to be eligible as collateral, issuers must provide representations and warranties that the underlying loans are in compliance with interagency regulatory guidance on sub-prime and nontraditional mortgage lending (the "Interagency Guidance"). As the FHFA and the FHLBanks now understand, due to the liability involved, issuers of securities are unlikely to provide such a representation or warranty. This representation and warranty requirement will, without some kind of safe harbor, likely eliminate PLMBS as a form of eligible collateral to a certain extent now, and increasingly so over time. Without such representations from an issuer, we are concerned that there are no other practical means to ensure compliance with interagency guidance.

(2) **This mandate is contrary to the public policy objective of having readily available credit for homeownership** – We believe this requirement may constrain the market for sale of whole loans and the securitization of residential loan assets, which in turn would have an adverse impact on the availability of credit to purchase homes. This may also adversely impact (i) loan sales and securitization and (ii) the availability of FHLBank advances to support residential lending. Consequently, on the margin this may have an adverse impact both on the availability and cost to individuals seeking home mortgages.

(3) **The impact of this requirement on credit availability may increase over time** - Although it is likely that the volume of PLMBS issued in the past two years and purchased by regulated financial institutions has been relatively low, this is probably a temporary condition. Due to changing market requirements, PLMBS are likely to become less exotic in structure and lower risk tranches and/or the issuance of private-label pass-through MBS may become more predominant. Such securities could become more appropriate for investment by banks, thrifts, credit unions, and insurance companies over time. The proposal to subject PLMBS ***purchased*** after July 10, 2007, to 2008-AB-02's requirements may hinder the development of a better PLMBS market, in that the liquidity of the instruments would be restricted and reduced. We are concerned that this may create the appearance of steering the securitization market to the GSEs, which is not in the spirit of supporting private capital markets.

Furthermore, this purchase date requirement may increase the likelihood that this market will remain illiquid as FHLBank members may be reluctant to participate as investors. For investors currently holding PLMBS, the purchase date requirement may increase the liquidity premium on such securities and possibly drive down prices, creating more loss for investors holding such securities as available-for-sale.

(4) **This clarification eliminates the possibility of re-securitizations –** It is not practical to determine whether securities issued prior to July 10, 2007 complied with guidance that had not yet been issued. To help this market recover, re-securitizations are important and should be encouraged as they will help to reduce pricing disparity. Healthy firms may be

able to re-securitize, use the discounted purchase price for additional credit enhancement and have the security re-rated. The flow of additional investment capital in the housing markets is beneficial. Therefore, re-securitizations should be eligible for pledging, provided they meet other FHLBank underwriting requirements for securities collateral.

(5) **The trigger date aspect of the requirement has a potentially disparate and illogical impact** – PLMBS and/or whole loans with identical characteristics may be eligible for pledge by one institution and ineligible for pledge by another due purely to differences in the date they were purchased. Although the objective may be to deter institutions from trading in and profiting from such securities by reducing their liquidity (*i.e.*, by restricting their contribution to an institution's advance availability after a certain date), we believe the market is addressing this issue and that loans made to borrowers that, for instance, cannot make payments at the fully indexed rate, have had their values significantly deteriorate due to elevated delinquency and loss rates. Our observation through visits to member institutions is that income verification and documentation of repayment capacity is becoming a standard practice. Reducing the salability or availability for securitization of these loans due to mandates on issuers that cannot be met is counterproductive to these developments. Reducing the salability of loans of troubled institutions is also counterproductive to their efforts to recover (*e.g.*, a nontraditional loan originated prior to the trigger date that is held by an undercapitalized member would be eligible for pledge, but the same loan, once sold to a stronger institution after the trigger date, would be ineligible).

(6) **Whole loan mortgages acquired by a member after July 10, 2007, must comply with interagency guidance –** The requirements of 2008-AB-02 call for members to certify that any mortgages acquired after July 10, 2007, comply with interagency guidance. Many troubled institutions try to recover financially by managing their balance sheets and capital ratios through the sale of whole loan assets to investors. These requirements, however, could greatly reduce the pool of potential investors and thus potentially hamper such restructuring efforts because no acquirer of such loans would be able to include them in the eligible loan pool to be pledged to an FHLBank. Additionally, mortgages acquired through Purchase & Assumption Agreements negotiated with the FDIC as a result of a bank failure and through routine mergers would also be subject to this standard. In both cases, mortgages collateralizing outstanding advances of the failed/selling institution may no longer be eligible as collateral to support the outstanding advances of the acquiring institution. This has the same disparate impact as described above. We believe that mortgages acquired through such transactions should remain eligible as collateral and any future guidance or clarification issued by the FHFA should provide for this.

In addition to the practical concerns noted above, we question whether the FHFA's proposed clarification would raise concerns with respect to equitable treatment of members as required by section 7(j) of the Federal Home Loan Bank Act (the "Bank Act"). Section 7(j) of the Bank Act requires that each FHLBank board of directors "administer the affairs of the bank fairly and impartially and <u>without discrimination in favor of or against any member borrower</u> . . ." 12 U.S.C. § 1427(j) (emphasis added). The FHFA's proposed clarification of Advisory Bulletin 2008-AB-02 would use as a trigger the date of acquisition rather than the date of origination of MBS or whole loans.

In so doing, MBS or whole loans with identical characteristics and creditworthiness may be eligible collateral to support advances for some members and ineligible for pledge by others, due solely to the date of acquisition of such assets by the member. We are concerned that such treatment, disconnected from a rational basis in the quality of the collateral or creditworthiness of the member, may be inconsistent with the requirements of Bank Act section 7(j).

(7) **If the FHFA maintains the proposed requirement for mortgages acquired after July 10, 2007 in the final version of 2008-AB-02, the implementation date of this requirement should be subject to further review by the FHFA** – The substance of the general requirement issue aside, we believe at a minimum the FHFA should reconsider the July 10, 2007, trigger date. Although the HERA study presents the purchase date requirement as a clarification, 2008-AB-02 ***clearly referred to the issue date***. The substitution of "purchase date" for "issue date" is a new requirement. As such, formal guidance should be issued (in the form of a new advisory bulletin or, preferably, a new rulemaking procedure providing opportunity for comments) to state this requirement. Therefore, only securities issued after July 10, 2007, and, at most, securities purchased after the date of any new guidance, in whatever form it takes, should be subject to the representation and warranty requirement. Failing to adjust the implementation date of any requirement runs contrary to language contained elsewhere in the HERA study. The study states: "…by adopting the effective date of the interagency guidance, the FHFB chose not to apply the advance collateral guidance retroactively. To have done so might have reduced access to liquidity and potentially added to the financial stress of some FHLBank member institutions at a time of increasing uncertainty in financial and housing markets." However, failing to grandfather loan or PLMBS purchases prior to issuance of any formal clarification violates this principle.

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The undersigned FHLBanks appreciate the opportunity to provide comment. We all support the effort to improve the quality of residential loan underwriting and the underlying premise behind interagency regulatory guidance to prevent the negative impact on both borrowers and lenders of poor policies, procedures, and practices as they relate to sub-prime and nontraditional mortgage lending. In that effort, we welcome the opportunity to work with the FHFA to develop policies and practices to prevent the FHLBanks from deliberately providing funding for mortgage loans that do not comply with such standards; however, only on a prospective basis and not by subjecting members to retroactive compliance.

As noted, we believe the restrictions on accepting privately issued securities, based simply on their purchase date, adversely and unfairly impact loans and investors. Applying an impossible standard, compliance with Interagency Guidance not in effect when many of the loans were made, serves to further freeze access to residential credit in a time that calls for increasing access to credit; and serves to unfairly subject different institutions owning the same or similar assets to different eligibility requirements. For these reasons, Interagency Guidance compliance requirements should be restricted to the primary focus of that guidance, the proper underwriting of whole loans made ***after*** the issuance of the guidance. Any requirements should not be implemented retroactively; thus, private-label mortgage-backed securities and whole loan mortgages issued or

originated prior to July 10, 2007, should remain eligible as FHLBank collateral, regardless of their purchase date.

We appreciate your consideration of our comments as the FHFA crafts a workable collateral standard to discourage improper and risky practices relating to sub-prime and nontraditional mortgage lending.

Sincerely,

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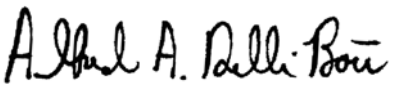
Federal Home Loan Bank of Boston  Edward A. Hjerpe, III, President and CEO	Federal Home Loan Bank of New York  Alfred A. DelliBovi, President
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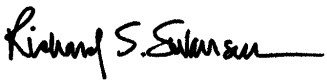
Federal Home Loan Bank of Des Moines  Richard S. Swanson, President & CEO	