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By e-mail to RegComments@FHFA.gov

Alfred M. Pollard, Esq.
General Counsel
Federal Housing Finance Agency
Fourth Floor
1700 G Street, N.W.
Washington, D.C., 20552

Attention: Comments/RIN 2590-AA30

Re: Proposed Rulemaking on Board of Directors of the Federal Home Loan
Bank System Office of Finance

Dear Mr. Pollard:

The Federal Home Loan Bank of Topeka appreciates the opportunity to comment on the Notice of Proposed Rulemaking published in the *Federal Register* August 4, 2009. The changes being proposed for the Office of Finance (OF) board of directors are long overdue and, if adopted, would constitute a critical improvement in the governance practices of the Federal Home Loan Bank System (System). We applaud the proposed rule and encourage the Federal Housing Finance Agency (FHFA) to move forward with issuing a final regulation consistent in substance with the proposed rule.

Structure of the Bank System

The Federal Home Loan Bank System is unique. The System is composed of 12 wholly independent corporate entities. Each Bank has its own membership, its own board of directors, its own management, its own capital and its own operating policies and practices. However, all Banks share one critical bond: all 12 Banks are jointly and severally liable for System debt.

The fact that all 12 Banks are independent of each other but jointly and severally liable for System debt creates an unusual dynamic. Because they are independent entities, no Bank has any ability to restrict or control the activities of another Bank despite the contingent liability that those activities may create for that Bank. In fact, even in the hypothetical situation where 11 Banks hold a common view that the 12th Bank is engaged in conduct the 11 perceive as unduly risky from a System perspective, the 11 are powerless to prevent the 12th Bank from engaging in that conduct.

There are existing checks and balances. All Banks are subject to the same statutory and regulatory restrictions. All are supervised and examined by the FHFA. All are subject to

audit by an independent audit firm. All are governed by a board of directors of which the majority are representatives of member institutions with a capital investment in the Bank and therefore a strong incentive to control risk at the Bank. But no Bank is subject to review, evaluation or control by the other Banks despite the joint and several liability to which the other Banks are exposed.

The nexus that necessitates the need for some type of System governance is the issuance of joint and several debt. If each Bank issued its own debt, joint and several liability would not be an issue. There would be no need for combined financial disclosures, and the complete absence of central control that exists today would be appropriate. However, the funding for each Bank comes overwhelmingly from the issuance of consolidated debt. The joint and several liability feature of System debt is a critical factor in the market's perception of the financial strength of consolidated debt, second only to the Banks' status as government-sponsored enterprises (GSEs).¹

Given that the link between the Banks is the responsibility for System debt, and the vital importance of System debt to the operations of each Bank, the board of directors that controls the issuance of System debt is the logical point at which to implement a central governance authority. It provides both the appropriate enforcement mechanism (access to the issuance of System debt) and the appropriate perspective through which any governance actions would be considered (System risk profile and System disclosures). A reconstituted OF board of directors would be uniquely and appropriately situated to provide needed System governance.

Requirements for an Effective OF Board

If the OF board is to effectively provide central governance relative to the issuance of consolidated debt, two conditions must be satisfied: representation and independence. First, the OF board must have representation from each Bank. If the OF board is to provide guidance on issues (because they have implications for consolidated debt), whether that be in the nature of appropriate limits on risk or guidance to achieve consistency in accounting, it should have representation from all of the affected parties. This is clear if one evaluates the System structure from the perspective of a voluntary business arrangement. The issuance of consolidated debt provides significant benefits to a participating Bank and would arguably provide the incentive to voluntarily agree to participate in the issuance of such debt. However, no business entity would agree to participate if it would arguably involve restrictions on its business practices and yet it did not have a seat at the table where those restrictions are determined nor any input into the risk taken by other joint obligors. The January 2000 Federal Housing Finance Board

¹ "A significant underpinning of the [baseline credit assessment] is the joint and several nature of the FHLBanks' consolidated obligations. The financial strength of individual FHLBanks is very sound, and the joint and several liability contributes to the overall strength of the FHLBank System by narrowing the ratings differences among the individual FHLBanks that could exist were ratings to exclude the joint and several feature." Moody's Investors Service, *Credit Opinion: Federal Home Loan Banks* (May 26, 2009). "The System enjoys low funding costs on its debt (termed 'consolidated obligations') due to joint and several liability on the combined strength of the 12 independent FHLBs." Standard & Poor's, *Ratings Direct: Federal Home Loan Banks*, p.2 (July 13, 2009).

proposed rule recognized that the presidents of all 12 Banks needed to be represented on the OF board and we commend the FHFA for incorporating this feature in the proposed rule. *See* 65 F.R. 324 (January 4, 2000). The presidents have the Bank knowledge, stature and time to effectively represent their Banks on the OF board.

The second condition is independence. In this era of enhanced focus on accounting and disclosures, there is a need for an unbiased evaluation of the accounting and disclosures of the System. While individual Banks are subject to the oversight of independent audit committees and boards (Bank boards of directors do not have any management representation), that same level of independence needs to be exhibited at the OF board of director level when it comes to evaluating accounting policy and disclosures. In addition, the FHLBanks are GSEs and the debt issued by the OF is perceived by the market as being backed by the Federal Government, notwithstanding explicit statements to the contrary in System disclosures. Federal assistance recently provided to Fannie Mae and Freddie Mac to support their debt holders has further increased the market's perception that the Federal Government stands behind GSE debt. This suggests that the responsibility of the OF board is broader than simply acting as an agent of the FHLBanks. That broader responsibility should be appropriately recognized in the composition of the OF board through the inclusion of independent directors.

We strongly support the FHFA's proposed requirement to have from three to five independent directors on the OF board and the proposed requirement to have an audit committee composed solely of independent directors. We also believe that the Banks will benefit from the perspective of independent directors in board discussions. The hallmark of an effective board is diversity of perspective and thought. While all 12 Bank presidents are necessary to meet the need for universal representation, the addition of independent directors will provide a level of diversity that will enhance the effectiveness of the OF board in all of its deliberations.

Accounting Consistency and Audit Committee Responsibilities

We support the rule's focus on achieving appropriate accounting consistency. However, we suggest that the allocation and definition of responsibilities be altered to reflect the appropriate discretion that must be accorded to independent entities to apply GAAP. FHFA should not impose accounting policies and procedures. Banking regulators and the audit profession have agreed that any regulator-imposed limitation on otherwise acceptable alternatives under GAAP is in and of itself a limitation on and a possible violation of GAAP.

We also believe that the establishment of accounting policies and procedures should be the province of the full OF board, not the audit committee. The audit committee's responsibilities should include overseeing the preparation of combined financial reports and, as part of that responsibility, evaluating whether there is sufficient consistency of accounting practice across the individual Banks necessary to issue acceptable combined financial reports. The adoption of accounting guidance should be the responsibility of the full board as all directors should have a seat at the table for those deliberations. If

alternative interpretations are acceptable under GAAP, it would be inappropriate for the audit committee to choose the preferred interpretation. The audit committee's responsibility should be to ensure that sufficient consistency has been achieved such that the committee can authorize the issuance of System combined financial reports.

While the regulator should not dictate accounting policy, we do believe it would be acceptable under GAAP for the OF board of directors to establish accounting guidance for the purpose of issuing System combined financial reports. The OF board of directors would not be dictating accounting policy, but rather imposing requirements in order to participate in the issuance of System consolidated debt. An individual Bank would not sacrifice its discretion to make judgments under GAAP; but to the extent it wants to issue System debt that imposes liability on the other Banks, a reasonable and appropriate requirement is that the Bank utilize accounting practices that lead to improved System disclosures. Each Bank's audit committee would need to determine independently that the OF board of directors' recommended accounting guidance is consistent with GAAP.

Comments on Specific Sections of the Proposed Rule

1273.3 Functions of the OF

(b) Consistent with the discussion on accounting policy above, we recommend deleting "using consistent accounting policies and procedures as established under section 1273.9 of this part" as the language is not necessary to the section and raises questions whether it creates an independent consistency requirement.

1273.4 FHFA oversight

(c) We are unclear what the ramifications of this section are and are unclear on what the intent was or why it was included. The section should be expanded, to better indicate its purpose, or removed.

1273.5 Funding of the OF

(b) We support the discretion granted to use a reasonable formula as well as providing the option for some type of fee-based reimbursement system.

1273.6 Debt management duties of the OF

(a) Consistent with the expanded role of the OF board of directors, we suggest the addition of the following sentence at the end of subsection (a): "Pursuant to the policies and procedures, the OF board of directors may limit or deny the issuance of consolidated obligations for one or more Banks."

(f) Consistent with the expanded role of the OF board of directors, we suggest that subsection (f) be amended to read as follows: "The OF shall timely monitor, compile relevant data on, and impose appropriate limits on each Bank's and the Bank System's exposure to risk necessary to facilitate the issuance of consolidated obligations."

1273.7 Structure of the OF board of directors

We support the structure provisions proposed, including the process for selecting directors, the definition of independence (including the requirement that an independent director may not serve as a director of a Bank), the selection of chairs and vice chairs, and the compensation provisions applicable to independent directors.

1273.8 General duties of the OF board of directors

(c) Under duties regarding COs, we suggest that language be included to make clear that the OF board of directors can limit or deny the issuance of consolidated debt for one or more Banks to enforce its policies including accounting guidance and limits on risk.

1273.9 Audit committee

(b) Consistent with the accounting discussion above, we suggest (2) be changed to state the following: "For purposes of the combined financial reports, the Audit Committee shall ensure that the Banks adopt accounting policies sufficiently consistent such that the information submitted by the Banks to OF may be combined to create accurate and meaningful combined financial reports" and (3) be moved to 1273.8 as a full OF board of directors responsibility.

We appreciate the opportunity to provide our comments on this important proposed rule and commend the FHFA for moving forward with a restructuring of the OF board of directors.



Ronald K. Wentz
Chairman of the Board



Andrew J. Jetter
President and CEO