

December 4, 2012

VIA EMAIL - RegComments@fhfa.gov

Alfred M. Pollard
General Counsel
Attention: Comments/RIN 2590-AA47
Federal Housing Finance Agency
Eighth Floor
400 Seventh Street SW
Washington, DC 20024

**Re: Notice of Proposed Rulemaking on Stress Testing of Regulated Entities;
Federal Housing Finance Agency ("FHFA"); RIN 2590-AA47**

Dear Mr. Pollard:

The Federal Home Loan Banks (the "FHLBanks" or "Banks") collectively thank you for the opportunity to comment on the FHFA's notice of proposed rulemaking on Stress Testing of Regulated Entities (the "Proposed Rule"), and also for providing an extension of the original comment deadline.

The FHLBanks recognize the value of stress testing, both to the Banks and to the FHFA, in determining whether the Banks have the capital necessary to absorb losses as a result of economic conditions. We therefore support the stress testing mandated by Section 165(i)(2) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), 12 U.S.C. § 5365(i)(2). The FHLBanks generally agree with the framework for stress testing set forth in the Proposed Rule. However, we respectfully request that the FHFA make certain changes to the Proposed Rule as described in this comment letter.

First and foremost, we ask that the FHFA postpone implementation of the Proposed Rule and initial stress test to provide adequate time for the Banks to implement stress testing processes, and to develop and validate required stress testing models. We also ask that you consider the additional comments included below, which include suggestions relating to the content and publication of stress testing results. Many of the changes we suggest would align the FHFA's stress testing rule with final rules recently published by other prudential banking regulators who are also required to implement Section 165(i) of the Dodd-Frank Act.¹

¹ See 77 Fed. Reg. 61238 (October 9, 2012) (Office of the Comptroller of the Currency ("OCC") final rule, 12 C.F.R. Part 46), available at <http://www.gpo.gov/fdsys/pkg/FR-2012-10-09/pdf/2012-24608.pdf>; 77 Fed. Reg. 62396 (October 12, 2012) (Federal Reserve Board of Governors final rule, 12 C.F.R. Part 252, Subpart H), available at <http://www.gpo.gov/fdsys/pkg/FR-2012-10-12/pdf/2012-24988.pdf>; 77 Fed. Reg. 62417 (October 15, 2012) (Federal Deposit Insurance Corporation ("FDIC") final rule, 12 C.F.R. Part 325) available at http://www.fdic.gov/regulations/laws/federal/2012/2012-10-15_final-rule.pdf. We note that the final rules issued by the other prudential regulators were published after the FHFA's Proposed Rule and that the FHFA may not have had the opportunity to review and analyze them before issuing the Proposed Rule.

I. Timing of Implementation

We note that the Proposed Rule does not provide a schedule for implementation. Consequently, as it is currently drafted, it is unclear when the FHLBanks would be required to perform their first stress tests and file reports with the FHFA and Federal Reserve Board of Governors, as this depends on the effective date and implementation of the final rule.

The FHLBanks request that the FHFA adopt an implementation schedule that provides the Banks sufficient time to develop, validate, and implement stress testing models and control processes before conducting the initial stress test. For the reasons discussed below, requiring the Banks to provide results without sufficient time to implement appropriate processes could lead to stress testing models and results that would be unsatisfactory both to the Banks and to the FHFA.

First, we note that the Proposed Rule will not be finalized until sometime after December 4, 2012 (the close of the extended comment period, *see* 77 Fed. Reg. 66566). We assume the FHFA's final rule would be issued at least 30-60 days after the comment deadline, after the January 5 deadline in the Proposed Rule for the Banks to provide annual stress test reports. The Banks would then develop stress testing processes, develop and validate testing models, perform tests using scenarios to be provided by the FHFA, and report results to the FHFA.² During this process, it would be beneficial if the timing allowed the opportunity for Bank staff to communicate with the FHFA on practical considerations regarding stress testing models, implementation, scenarios, and inputs.

Second, we emphasize that this will be the first time the Banks will perform stress testing at the direction of regulators. In contrast, many other financial institutions that will be conducting stress tests in 2012 were previously involved in regulator-driven stress testing, such as the 2009 Supervisory Capital Assessment Program (“SCAP”).³ The other prudential regulators have acknowledged the differences in preparedness for stress testing among their regulated entities by using a phased implementation approach by asset size⁴ and, in the case of the Federal Reserve, by permitting banks which have not yet performed stress testing (through a holding company stress test) to conduct their first stress test in the fall of 2013.⁵

Third, due to our unique structure, the FHLBanks have significantly less staff and other resources available to implement stress testing compared to the large depository institutions that will be conducting tests in the fall of 2012. Based on discussions among the Banks, it is clear that significant efforts will be needed to comply with the Proposed Rule. In addition to requiring stress testing, the Proposed Rule also requires the FHLBanks to establish and maintain controls, oversight, and documentation (including policies and procedures) to ensure the stress testing

² The final rules on stress testing promulgated by the OCC, Federal Reserve, and FDIC were each issued by October 15, 2012, and the regulators will provide scenarios to their regulated entities to use in conducting those tests no later than November 15. *See supra* at n. 1; 12 C.F.R. § 46.5(b) (OCC); 12 C.F.R. § 252.154(b) (Federal Reserve); 12 C.F.R. § 325.204(b) (FDIC).

³ *See* 77 Fed. Reg. at 62396-62397 (preamble to Federal Reserve rule, discussing SCAP testing and the Comprehensive Capital Analysis and Review (CCAR) stress tests in 2010).

⁴ The OCC and the FDIC will implement stress testing in phases. National banks and state nonmember banks with \$50 billion or more in assets will conduct their first tests as of September 30, 2012 (but may request an extension on a case-by-case basis), and entities with assets totaling more than \$10 billion but less than \$50 billion will conduct their first stress test as of September 30, 2013. *See* 77 Fed. Reg. at 61239 (OCC) and 77 Fed. Reg. at 62418 (FDIC).

⁵ *See* 12 C.F.R. § 252.153(a)(2)(ii) (Federal Reserve).

processes are effective. *See* Proposed Rule (“P.R.”) § 1238.4(d)(1). These controls must include procedures for methodology, validation and integrating test results into capital planning and risk management, which will require time to implement.

Therefore, the Banks request that the FHFA allow at least 180 days from the date the FHFA publishes the final rule (or the date the FHFA provides scenarios for the tests, whichever is later) for the Banks to provide a stress test report to the FHFA.⁶

We also request that the first publication of stress test results occur after the second stress test (in April 2014, ninety days after a report is due on January 5, 2014 for September 30, 2013 data). This approach will permit the Banks to incorporate input that is received from the FHFA related to the initial stress test before publishing results, and will ensure that publicly reported test results are consistent with the FHFA's regulatory goals and intent.⁷

II. Timing for Providing Scenarios

The Proposed Rule does not set a date by which the FHFA will provide the Banks with scenarios to use in their stress testing, nor does it provide any detail as to the inputs required for the related scenarios. The Banks expect that some time will be required for them to understand and implement the framework for the scenarios and adjust their models. Also, the Proposed Rule notes that trading and counterparty exposures will be incorporated into stress tests “for which FHFA will communicate the required as of date in the fourth quarter of each year.” P.R. § 1238.3(a)(1).

We, therefore, request that the final rule specify that: (i) the FHFA will provide scenario inputs to the Banks no later than November 15 of each year, and (ii) the FHFA will provide the required “as of” date for counterparty and trading exposures by December 1 of each year.⁸ This would ensure that the FHLBanks have adequate time to conduct stress testing before the January 5 due date for reporting results to the FHFA. We also request that the FHFA communicate with the Banks (formally or informally) regarding scenario inputs before providing them in final form.

III. Methodology

The FHLBanks request that the methodology section of the rule (P.R. § 1238.4) state that the stress testing and related reports will be required to address only items that would be material to

⁶ However, we also note that if reporting is required during midyear 2013, this reduces the time period between stress tests significantly. There would be limited time for the FHFA to review results and procedures from the initial test performed using 2012 data, and for the FHLBanks to implement any necessary changes to testing processes, before conducting a second test using September 2013 data.

⁷ *Cf.* 77 Fed. Reg. at 61241 (OCC); 12 C.F.R. § 252.157 (a)(2) (Federal Reserve); 77 Fed. Reg. at 62418 (FDIC) (postponing the publication requirement until 2015 for institutions with assets totaling between \$10 billion and \$50 billion, most of which will perform their first stress test in 2013, so that publication of the first stress test is not required).

⁸ These dates are the same as those required by other prudential regulators, although entities without significant trading activity will not be required by the other regulators to include trading and counterparty components in their stress tests. *See* 12 C.F.R. § 46.5(b), (c) (OCC); 12 C.F.R. § 252.154(b)(1), (2) (Federal Reserve); 12 C.F.R. § 325.204(b), (c) (FDIC).

a Bank's capital and earnings.⁹ Further, we request that the FHFA's guidance on stress testing clarify how to incorporate into the stress testing process the defensive measures that Banks may take to preserve capital and earnings in a stress scenario (e.g., suspending or limiting dividends, stock repurchases or redemptions).

The Banks also request that the FHFA's stress test methodologies (and resulting stress test reports) not include market value of equity for future periods.¹⁰ We believe this is not a relevant measure because a typical FHLBank's balance sheet is managed more consistently with a held-to-maturity philosophy and is able to withstand periodic market fluctuations.¹¹

We also ask that the FHFA clarify that the Banks may use their own, supported business assumptions for inputs such as replenishment of runoff assets and liabilities (using modeling, historical analysis, or other approaches) to calculate future income projections when the Banks perform stress testing calculations using the scenarios provided by FHFA.

IV. Additional Analytical Techniques

The Proposed Rule states that the FHFA “may determine that additional analytical techniques and exercises are appropriate” for a regulated entity to use in identifying, measuring and monitoring risks, and adds that the FHFA may require such entity to implement these techniques and exercises. P.R. § 1238.4(c). While the Banks acknowledge the FHFA's potential need for additional testing and analysis, we request that the FHFA provide prior notice and an opportunity to comment before requiring such testing. This would be consistent with the approach taken by the other prudential regulators.¹² In addition, this approach would encourage communication between the FHFA and the relevant Bank(s) to address the FHFA's concerns and to identify the best way for the Bank(s) to provide the requested information.

V. Oversight

The Proposed Rule requires the board of directors and senior management of each FHLBank to “approve and annually review” the Bank's stress testing controls, oversight, and documentation, including policies and procedures, to ensure compliance with the Rule. *See* P.R. § 1238.4(d)(2). We request that the final rule allow (at a Bank's discretion) a board committee, rather than the full board, to conduct this annual review. This would be consistent with the final rules issued by other prudential regulators and would reduce administrative burden, considering the numerous policies that each Bank's board of directors reviews each year. The final rule could include the

⁹ For example, if the level of acquired member assets (“AMA”) held by a Bank is very low, performing a credit summary of the Bank's AMA portfolio, as suggested by the preamble to the Proposed Rule, 77 Fed. Reg. at 60950, would provide little value in projecting the Bank's ability to withstand significant financial pressures.

¹⁰ The OCC, FDIC, and the Federal Reserve do not require their regulated entities to calculate future market value of equity in their stress tests. *See* 12 C.F.R. § 46.6 (OCC); 12 C.F.R. § 252.155 (Federal Reserve); 12 C.F.R. § 325.205 (FDIC).

¹¹ As an alternative, the methodology could include estimates of the impact of future other than temporary impairment (“OTTI”) due to credit losses, where relevant for individual Banks. OTTI measurements that estimate future cash flows are likely more reliable than future estimates of market value.

¹² *See* 12 C.F.R. § 46.4(c) (OCC); 12 C.F.R. § 252.154(b)(4) (Federal Reserve); 12 C.F.R. § 325.201(c)(5) (FDIC).

requirement that the full board receive a summary of the annual stress test results, in order to ensure they are informed.¹³

VI. Confidentiality

Because of the highly sensitive nature of stress test results, the FHLBanks request that the final rule expressly provide that stress test results (other than the published summary of results) are confidential and exempt from disclosure under 12 C.F.R. § 1202.4, and thus will generally not be released. The Proposed Rule states that stress test reports will be subject to the Freedom of Information Act (“FOIA”), and regulations of the FHFA and the Federal Reserve Board. *See* P.R. § 1238.5(c). Presumably, stress test results would be exempt from disclosure pursuant to a FOIA request because, among other things, they relate to examination, operating, or condition reports prepared for the use of the FHFA. *See* 12 C.F.R. § 1202.4(a)(8). However, the FHLBanks request that the FHFA add to the final rule express provisions regarding confidentiality to clarify to potential requesters that stress test results are generally not the type of information that would be disclosed. The OCC’s regulation on stress testing includes such provisions. *See* 12 C.F.R. § 46.7(c).

VII. Report Contents

The Proposed Rule states that the FHLBanks will file stress testing reports on a form established by the FHFA, *see* P.R. § 1238.5(b), and the preamble to the Rule sets forth several elements which the FHFA is considering including in the annual report. *See* 77 Fed. Reg. at 60950. The FHLBanks request that the FHFA follow the approach taken by other prudential regulators and publish a proposed report form for comment. *See* 77 Fed. Reg. 49485 (August 16, 2012) (OCC’s proposed report form for institutions over \$50 billion).

The Banks also request clarification on the FHFA’s proposal that the reports include an “income statement (reflecting a comparable level of detail to SEC filings),” since this may include data that is not relevant or material to stress test results. Also, the FHFA proposes that FHLBanks report on “[t]he sensitivity of the book value of capital and market value of equity¹⁴ to other factors at the ‘as of’ date of the stress test” (emphasis added). We request that the FHFA specifically identify the “other factors” to be applied so that the Banks have an opportunity to comment on them. In addition, the Banks request clarity on the other proposed elements for the stress test report, including what should be considered “Credit-related expenses” and “foreclosed property expenses.” 77 Fed. Reg. at 60950.

VIII. Publication

The Proposed Rule implements the statutory requirement that the FHLBanks publish a summary of the results of stress tests. *See* P.R. § 1238.7. Specifically, the Proposed Rule requires the Banks to publish stress test results such as aggregate losses, pre-provision net revenue, and pro forma capital levels under each scenario provided by the FHFA. In contrast, the other prudential regulators have required covered entities to disclose results under only the *severely adverse*

¹³ *See* 12 C.F.R. § 46.6(c)(2) (OCC); 12 C.F.R. §252.155(c)(2) (Federal Reserve); 12 C.F.R. § 325.205(b)(2) (FDIC).

¹⁴ *See* comments regarding market value of equity in Section III, *supra*.

scenario.¹⁵ Significantly, the public could interpret published results under the baseline scenario as equivalent to earnings forecasts.

As the OCC noted in the preamble when finalizing its stress testing rule, “[s]everal commenters expressed concern with disclosing baseline forecasts because these forecasts may be interpreted as earnings guidance.” As a result, the OCC “revised the final rule to require the disclosure of losses only for the severely adverse scenario.” *See* 77 Fed. Reg. at 61241.¹⁶ The Banks urge the FHFA to follow this same approach, since publishing results for all scenarios could cause tension between the Banks’ reporting obligations as SEC registrants and their obligation to publish a summary of stress test results. Publishing results for only the severely adverse scenario should satisfy the intent of the publication requirement, namely to inform the public of the Banks’ ability to withstand significant financial pressures.

We also note that the proposed timeline for reporting stress test results and publishing a summary of such results might impact the Banks’ obligations under the securities laws. While the Proposed Rule requires stress test results to be reported to the FHFA by January 5, it does not mandate public disclosure until 90 days later. Under the proposed timeline for publication, stress tests results could be deemed material information that must be disclosed (through a Form 10-K or perhaps a Form 8-K) prior to the FHFA’s required publication. Consequently, we urge the FHFA to ensure that the final rule does not prohibit disclosure of stress test results that might be considered material and, therefore, would be required in securities filings.¹⁷

As noted previously, the FHLBanks also request that the date for publication of the Banks’ initial stress test results be postponed until 2014 (reporting results of the stress test performed as of September 30, 2013), to allow time for the FHFA and the Banks to resolve any questions or issues that may arise during the Banks’ initial stress testing cycle.

IX. Uniformity

The preamble to the Proposed Rule states that “[i]n implementing the regulation, FHFA will define scenarios for the regulated entities, bearing in mind the key risk exposures at each regulated entity.” 77 Fed. Reg. at 60950. The FHLBanks request clarification as to whether the FHFA will provide the same scenarios for each of the Banks.

The FHLBanks believe that the purposes of the stress testing requirement would be best served by providing the same scenarios to each Bank, with the exception of region-specific use of House Price Indexes. Using the same scenarios will facilitate uniform comparison of stress test results. However, the FHLBanks note that scenarios appropriate for the Banks may be different than the scenarios that are appropriate for the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac).¹⁸

¹⁵ *See* 12 C.F.R. § 46.8(c), (d) (OCC); 12 C.F.R. § 252.157(b) (Federal Reserve); 12 C.F.R. § 325.207(c) (FDIC).

¹⁶ *See also* 77 Fed. Reg. at 62402 and 77 Fed. Reg. at 62402 (similar comments from Federal Reserve and FDIC).

¹⁷ *See, e.g.*, FHFA Advisory Bulletin 2009-AB-01, July 20, 2009 (Disclosure of Preliminary Capital Classifications) and Federal Housing Finance Board Advisory Bulletin 2006-AB-03, July 18, 2006 (Disclosure in SEC Filings of “Unpublished Information” as Defined in Part 911 of the Finance Board Rules and Regulations).

¹⁸ As noted in the Proposed Rule, Section 1313 of the Safety and Soundness Act (as amended by the Housing and Economic Recovery Act) requires the Director of the FHFA to consider the differences between the Banks and the Enterprises whenever promulgating regulations that affect the Banks. *See* 12 U.S.C. § 4513(f).

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We appreciate the opportunity to provide comments on the Federal Housing Finance Agency's proposed rule on Stress Testing of Regulated Entities. Please contact Kenneth Ferrara, Senior Vice President and Chief Risk Officer for the Federal Home Loan Bank of Dallas, at (214) 441-8457 or Kenneth.ferrara@fhlb.com, with any questions you may have.

Respectfully submitted,

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