FHLB Chicago

Federal Home Loan Bank of Chicago

April 21, 2010

VIA ELECTRONIC MAIL

Alfred M. Pollard, Esq.
General Counsel
Federal Housing Finance Agency
1700 G Street, N.W., Fourth Floor
Washington, DC 20552
Attn: Comments/RIN 2590-AA24

Re: Comments on Proposed Rulemaking Use of Community Development Loans by Community Financial Institutions to Secure Advances; Secured Lending by Federal Home Loan Banks to Members and Their Affiliates; Transfer of Advances and New Business Activity Regulations

Dear Mr. Pollard:

The Federal Housing Finance Agency ("FHFA") has issued a notice of proposed rulemaking with respect to community financial institutions using community development loans to secure advances and secured lending by a Federal Home Loan Bank ("FHLB") to members and affiliates. This letter sets forth the comments of the Federal Home Loan Bank of Chicago ("Bank") with respect to the secured lending provisions of the proposed rule ("Proposed Rule"). We thank you for the opportunity to provide comments on this important matter.

The Bank agrees with the FHFA that a secured loan from an FHLB to one of its members (including a reverse repurchase agreement that has the effect of substituting for an advance) should be treated as an advance subject to the requirements of the advances regulation. However, we are concerned that the broad language in proposed §1266.2(e), covering "all secured extensions of credit," would prohibit more than just transactions designed to evade, or having the effect of evading, the application of the advances regulation to secured loans to a FHLB's members. In particular, the Bank is concerned that this language may have the effect of limiting necessary investment and risk management transactions by the FHLBs. The Bank recommends that proposed §1266.2(e) be modified so that the provision in the final regulation reads as follows:

> **(e) *Status of secured lending*. All secured transactions, regardless of the form of the transaction, for money borrowed from a Bank by a member of that Bank shall be considered an advance subject to the requirements of this part. All secured transactions, regardless of the form of the transaction, for money borrowed from a Bank by a nonmember affiliate of a member of that Bank are prohibited, except for bona fide investment transactions, to the extent authorized under section 956.2 of this title, with (i) primary dealers in government securities recognized by the Federal Reserve Bank of New York and (ii) other financial institution**

counterparties meeting the credit and other risk management requirements established by that Bank.

We believe this approach is preferable for three reasons.

First, this language makes it clear that collateralized obligations owed to an FHLB by a counterparty under a derivative contract would not be considered an "advance" for these purposes, since such obligations do not involve the actual borrowing of money from the FHLB. Net amounts owing to an FHLB under an interest rate swap have never been viewed as equivalent to an advance for all purposes,[1] and should not be so viewed going forward. Likewise, there can be other obligations owed to an FHLB that have nothing to do with borrowed money (e.g., contingent obligations relating to the future recapture of AHP funds or contingent obligations under an indemnification provision in a member or vendor contract). The key concept for purposes of §1266.2(e) should be whether there has been a secured money borrowing as part of the transaction.[2]

Second, the substitute language fixes what the Bank believes is a technical error in the proposed rule. The proposal by its terms prohibits an FHLB from making any secured extension of credit to "an affiliate of any member." However, most if not all of the FHLBs have certain members whose affiliates are also members of the same FHLB. The proposed rule as written would prevent an FHLB from making advances to a member, if that member is an affiliate of another member that has received advances. The substitute language clarifies that the bar on advances to affiliates only applies to nonmember affiliates of a member.

Finally, this language would preserve the authority of an FHLB to enter into reverse repurchase transactions with a primary dealer in government securities recognized by the Federal Reserve Bank of New York and other high credit quality financial institutions. Such transactions were permitted under Section II.B.2. of the Federal Housing Finance Board's Financial Management Policy (FMP)[3] and are currently permissible under Finance Board Resolution 93-

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[1] For example, stock purchase requirements under an FHLB's capital plan.

[2] In addition, there are cases where direct and contingent obligations owed by a member to an FHLB are incurred or underwritten on an unsecured basis, e.g., Fed funds transactions ("unsecured obligations"). In some such instances, however, collateral held by the FHLB under its advances and security agreement will, as a legal matter, also extend to secure the unsecured obligations. Even if an FHLB does not have such a "dragnet clause" in its advances and security agreement, this collateralizing of unsecured obligations owing by members may occur automatically by operation of law, since both §10(c) of the Federal Home Loan Bank Act and §950.7(e)(1) of Federal Housing Finance Board ("Finance Board") regulations grant an FHLB a lien in a member's stock in the FHLB "as further collateral security for all *indebtedness* of the member to the Bank." (emphasis added) In such situations, the Bank would view the unsecured obligations as not being "secured extensions of credit" within the meaning of the proposed rule or "secured transactions" under the substitute language proposed above, even though as a legal matter the obligations technically remain secured and benefit from the usual contractual security interests and statutory liens.

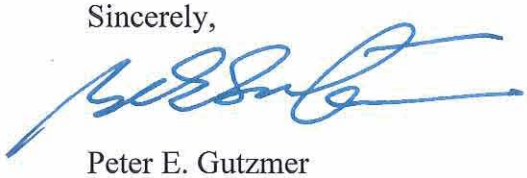
[3] This section of the FMP listed the following as one of the permissible investments for an FHLB:

133 and §956.2(f) of Finance Board regulations,[4] both of which remain in effect. These transactions are permitted under current rules even when the primary dealer is an affiliate of an FHLB member. Preserving this existing flexibility in the FHLBs' investment authority is especially critical at a time when many FHLBs are increasing capital levels. Capital conservation efforts will be less successful for the FHLBs without the ability to invest such additional capital in an economic manner.

The Bank also requests that the FHFA, in addition to adopting the substitute §1266.2(e) language above, clarify in the preamble to the final rule that the provision neither requires an FHLB to treat investments in mortgage-backed securities as advances to the issuer nor prohibits an FHLB from continuing to accept affiliate collateral pledges to secure advances to members as permitted under §950.7(g)[5] of the advances regulation. These clarifications would merely recognize long-standing policy and practice within the FHLB System, and provide additional assurance that no unintended changes will result from the adoption of §1266.2(e).

The FHLBC thanks the FHFA for its consideration of these comments.

Sincerely,



Peter E. Gutzmer
Executive Vice President, General Counsel
& Corporate Secretary

"Overnight and term resale agreements, that on the settlement date have a remaining term to maturity not exceeding 9 months, placed with eligible counterparties."

"Eligible counterparties" was then defined in footnote 2 to include primary dealers, the New York Federal Reserve Bank, U.S. Government Sponsored Enterprises, and, on a more limited collateral basis, the Bank for International Settlement and certain central banks of foreign countries.

[4] The May 3, 2001 version of the FMP promulgated by the Finance Board stated that "(i)nvestments formerly authorized under §§ II.B.1 through 5 and § II.B.9 of the FMP are now authorized under 12 CFR § 956.2(f)."

[5] The proposed rule would redesignate this as §1266.7(g).