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Richard M. Riccobono
President and Chief Executive Officer

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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, NW
Washington, D.C. 20552

Re: Comments on Proposed Rulemaking Regarding 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; RIN 2590-AA24

Dear Mr. Pollard:

The Federal Home Loan of Seattle ("Seattle Bank") appreciates this opportunity to comment on the Federal Housing Finance Agency ("FHFA") proposed rule implementing aspects of Section 1211 of the Housing and Economic Recovery Act of 2008 and addressing the referenced subjects. The Seattle Bank respectfully submits the following comments regarding secured lending by Federal Home Loan Banks ("FHLBanks") to members and their affiliates for your consideration.

We agree with the FHFA that a secured loan from an FHLBank 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 section 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 Bank's members. In particular, we are concerned that this language may have the effect of limiting necessary investment, liquidity management, and risk management transactions by the FHLBanks. We recommend that proposed section 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 clear that collateralized obligations owed to an FHLBank 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 FHLBank. Net amounts owing to an FHLBank under an interest rate swap have never been viewed as equivalent to an advance for all purposes1, and should not be so viewed going forward. Likewise, there can be other obligations owed to an FHLBank 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 section 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 we believe was a technical error in the proposed rule. The proposal by its terms prohibits an FHLBank from making any secured extension of credit to "an affiliate of any member." However, most if not all of the FHLBanks have certain members whose affiliates are also members of the same FHLBank. The proposed rule as written would prevent an FHLBank 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 FHLBank 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

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

[2] In addition, there are cases where direct and contingent obligations owed by a member to an FHLBank are incurred or underwritten on an unsecured basis, e.g., indemnification obligations, AHP recapture obligations, and Fed funds transactions ("unsecured obligations"). In some such instances, however, collateral held by the FHLBank under its advances and security agreement will, as a legal matter, also extend to secure the unsecured obligations. Even if an FHLBank 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 section 10(c) of the Federal Home Loan Bank Act and section 950.7(e)(1) of Federal Housing Finance Board regulations grant an FHLBank a lien in a member's stock in the FHLBank "as further collateral security for all *indebtedness* of the member to the Bank." (emphasis added) In such situations, we 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 FHLBank:

"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,

Resolution 93-133 and section 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 FHLBank member. Preserving this existing flexibility in the FHLBanks' investment authority is especially critical at a time when many FHLBanks are increasing capital levels. Capital conservation efforts will be less successful for the FHLBanks without the ability to invest such additional capital in an economic manner. In addition, FHLBanks need access to a variety of safe and sound investments in order to warehouse liquidity. Restricting the availability of sources for warehousing liquidity could adversely impact the FHLBanks by reducing the amount of liquidity that they maintain and/or by reducing the diversification and increasing the credit risk profile for those amounts of liquidity that they continue to maintain.

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

The Seattle Bank thanks the FHFA for its consideration of these comments.

Sincerely,

Richard M. Riccobono
President and Chief Executive Officer

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 section 1266.7(g).