FHLBBoston

April 26, 2010

VIA EMAIL

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

RE: Proposed Rule Regarding Secured Lending by Federal Home Loan Banks ("*FHLBanks*") to Members and Their Affiliates ("*Proposed Section 1266.2(e)*")

Dear Mr. Pollard:

Thank you for the opportunity to provide comments to the Federal Housing Finance Agency's (the "*FHFA's*") Proposed Section 1266.2(e). 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. As a related point, we are also concerned about the proposed extension of the restriction to any affiliate of any member. In particular, we are concerned that this language may have the effect of limiting necessary investment and liquidity management transactions by the FHLBanks.

Based on the language of Proposed Section 1266.2(e), we believe the following unintended consequences would result:

- The FHLBanks would be left with fewer eligible counterparties for reverse repurchase transactions since most of our reverse repurchase counterparties are affiliates of other FHLBanks' members. To effectively serve in their role as liquidity providers to member financial institutions, FHLBanks must maintain a substantial portfolio of short-term, liquid investments that provide a reliable intraday funding source under all market conditions. With yields that are often competitive with unsecured money-market investments, reverse repurchase agreements are an important short-term liquidity management tool for the FHLBanks and are, at times, the best short-term investment option on a risk-adjusted basis. Furthermore, at times of stress in the credit markets, such as those experienced in the latter half of 2008, the FHLBanks rely heavily on secured money market investments through the reverse repurchase agreement market, as unsecured investments become too risky.

  Most major financial institutions operating within the United States have a

subsidiary that is a member within the FHLBank system, and these subsidiaries often have affiliates that engage in repurchase agreements. As such, these major counterparties would no longer be eligible reverse repurchase transaction counterparties. Reducing the number of eligible counterparties for these agreements would adversely impact each FHLBank's ability to invest its liquidity at a positive spread to its funding cost. Moreover, it would force greater reliance on unsecured money market transactions, thereby increasing credit risk for the FHLBanks.

- Collateralized obligations owed to an FHLBank by a counterparty under a derivative contract may be considered secured extensions of credit. However, collateralized amounts owing to a Bank under a derivative contract have never been viewed as equivalent to an advance for any regulatory purpose[1], and should not be so viewed going forward. The obligations that arise from this activity result from market movements and do not reflect a financing transaction. We do not believe the FHFA intended to capture these transactions in Proposed Section 1266.2(e).

- Obligations owed to an FHLBank that have nothing to do with borrowed money may be considered secured extensions of credit. Examples of such obligations include contingent obligations relating to the future recapture of Affordable Housing Program funds or contingent obligations under an indemnification provision in a member or vendor contract. The key test under the final regulation should be whether there has been a secured money borrowing as part of the transaction.[2]

To avoid these unintended consequences, 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 or an**

[1] For example, collateralized amounts owing to a Bank under a derivative contract have never been subject to the 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 Agency's 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.

affiliate of 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 another Bank, are prohibited, except for investment transactions, to the extent authorized under section 956.2, with (i) broker dealers registered with the Securities and Exchange Commission and (ii) other financial institution counterparties meeting the credit and other risk management requirements established by that Bank.

This approach will ensure that the unintended consequences identified above are outside the scope of the final regulation.

Additionally, the substitute language fixes what we believe was a technical error in Proposed Section 1266.2(e), which, 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. Proposed Section 1266.2(e), 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.

We also request that the FHFA, in addition to adopting the substitute section 1266.2(e) language above, clarify in the adopting release for the final rule that the provision:

- does not prohibit an FHLBank from continuing to accept affiliate collateral pledges to secure advances to members as permitted under section 950.7(g)[3] of the advances regulation; and
- has been revised specifically to ensure that the unintended consequences identified herein are intended to be remedied by the final regulation.

These clarifications would merely recognize long-standing policy and practice within the FHLBank System, and provide additional assurance that no unintended consequences will result from the adoption of section 1266.2(e).

Thank you for your consideration of our comments.

Sincerely,

Edward A. Hjerpe III
President and Chief Executive Officer
Federal Home Loan Bank of Boston

[3] The proposed rule would re-designate this as section 1266.7(g).