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By e-mail to [RegComments@FHFA.gov](mailto:RegComments@FHFA.gov)

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Attention: Comments/RIN 2590-AA01

Re: Proposed Rulemaking on Minimal Capital

Dear Mr. Pollard:

Thank you for the opportunity to provide comments to the Federal Housing Finance Agency (“FHFA”) regarding its proposed rule establishing standards for imposing temporary increases to the minimum capital requirements applicable to the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation (together, the “Enterprises”) and the Federal Home Loan Banks (“FHLBanks”). This is an issue of utmost importance to the FHLBanks and their member-shareholders. We, the undersigned FHLBanks, are sensitive to and supportive of the policy rationale for this rule, and understand that additional capital may be needed in certain circumstances. However, we believe that the following comments will be helpful to you in implementing the final rule in a way that better protects the investment of the FHLBanks’ member-shareholders.

I. Consideration of Differences between the FHLBanks and the Enterprises as Required by HERA Section 1201

Section 1201 of the Housing and Economic Recovery Act of 2008 (“HERA”), pursuant to which the FHFA was established, requires the Director of the FHFA to consider the differences between the FHLBanks, on the one hand, and the Enterprises, on the other, before promulgating any regulation or taking any formal or informal agency action of general applicability and future effect relating to the FHLBanks.<sup>1</sup> In particular, the Director should consider the FHLBanks’ cooperative ownership structure, mission of providing liquidity to members, mission of supporting affordable housing and community development, capital structure and joint and several liability.<sup>2</sup>

As drafted, the proposed rule would seem to apply to the FHLBanks and the Enterprises with little distinction drawn between them. The proposed rule does not indicate that the Director has conducted the substantive review required by section 1201 of HERA,

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<sup>1</sup> 12 U.S.C. § 4513(f).

<sup>2</sup> *Id.*

and in fact, lacks a statement to that effect, which typically has been included in most agency actions promulgated by the FHFA since the enactment of HERA.

At a minimum, the FHLBanks are distinguishable from the Enterprises based on the fact that the FHLBanks (i) are not in conservatorship, (ii) are not operated by the FHFA, (iii) are not receiving substantial equity investments from the federal government, (iv) do not have publicly traded equity securities, and (v) are cooperatives.

In addition, the capital raising process for the FHLBanks under their capital plans is not at all like that which would be undertaken by a publicly-traded company, such as the Enterprises. Moreover, the events of the recent financial crisis have demonstrated that the FHLBanks' cooperative structure provides substantial advantages in terms of capital adequacy over that of a publicly-traded model. As members of an FHLBank increase their borrowings from their FHLBank, they must correspondingly increase their equity investment in the FHLBank in accordance with the FHLBank's capital plan.

Given the uncertainty concerning the future structure of the Enterprises, and the substantial differences between them and the FHLBanks in terms of their current capital structure, the FHFA should consider separating the requirements for temporary increases in minimum capital by the Enterprises and the FHLBanks into distinct rules, or at a minimum, subsets of the same rule. Any such proposed rulemaking specifically should take into account the unique capital structure of the FHLBanks and their status as member-owned cooperatives.

## II. Notice of a Temporary Increase in an FHLBank's Minimum Capital Requirement

In the past, FHLBank members have expressed concerns about the extent of their obligation to capitalize their FHLBanks and the need for certainty, to the fullest extent possible, with respect to their obligations. The Federal Housing Finance Board (as predecessor to the FHFA) in adopting amendments to the final capital regulation, stated that it did not believe that the provision of the FHLBank Act requiring members to comply promptly with any increase in minimum stock investment requirements<sup>3</sup> provides the FHLBanks with an unlimited call on the assets of their members to capitalize the FHLBanks.<sup>4</sup> Additionally, pursuant to the FHLBank Act and the final capital regulations, each FHLBank was required to adopt a capital plan establishing the way in which each member's minimum capital stock investment is determined and the notice and other requirements applicable to increases in the minimum requirement.

The proposed rule states that the Director of the FHFA would provide notice to an FHLBank thirty (30) days in advance of the effective date of any temporary increase in an FHLBank's required minimum capital level.<sup>5</sup> An FHLBank would then have 15 days to provide the FHFA with comments or objections to the temporary increase.<sup>6</sup>

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<sup>3</sup> 12 U.S.C. §1426(c)(1)(D).

<sup>4</sup> See 66 Fed. Reg. 8262, 8304 (January 30, 2001).

<sup>5</sup> Section 1225.3.

<sup>6</sup> Unless the Director determines that an exigency exists, in which case the time periods could be shortened.

The FHLBanks believe that the final rule should clarify whether the effective date for a temporary minimum stock requirement refers to the date on which an FHLBank is required to issue additional capital stock to its members, or the date on which the FHLBank must implement the steps under its capital plan that are required to impose an additional stock purchase on that FHLBank's members. The FHLBanks have a cooperative capital stock structure and can only issue stock to their members. Moreover, the FHLBanks are bound to operate in compliance with the terms of their capital plans with respect to increases in their members' minimum stock purchase requirement. Furthermore, a temporary increase in the minimum stock purchase requirement may require an amendment to an FHLBank's capital plan. The FHLBanks suggest that, in its final rule, the FHFA reference that the FHLBanks will be required to comply with the terms of their respective capital plans (including notice periods) in regard to implementing any temporary increase in the minimum stock purchase requirement for an FHLBank's members and, therefore, an FHLBank will not be deemed to be in violation of any increased minimum capital requirement while it implements such temporary increase in the minimum stock purchase requirement.

We also believe that the final rule should cross-reference the procedures established by the FHFA in 12 C.F.R. §1229.11 for requiring FHLBanks to comply with a temporary increase in minimum capital. In promulgating 12 C.F.R. Part 1229, the FHFA recognized that the FHLBanks are limited in their ability to quickly raise additional capital because of the FHLBanks' cooperative capital stock structure and capital plans. In light of these limitations, the FHFA requires undercapitalized and significantly undercapitalized FHLBanks to submit a capital restoration plan to "restore its permanent and total capital to levels sufficient to fulfill its risk-based and minimum capital requirements within a reasonable period of time. Such plan must be feasible given general market conditions and the conditions of the Bank...".<sup>7</sup> We believe that it would be helpful to apply the same capital restoration plan requirements to an FHLBank in the event the FHFA temporarily increases the minimum capital requirement, particularly given the close interaction of these two provisions of the regulations.

### III. Standards for Imposing a Temporary Increase in Minimum Capital

The proposed rule establishes 11 standards and factors that the Director may consider in determining whether to impose temporary minimum-capital increases on an FHLBank.<sup>8</sup> The FHLBanks believe that the proposed standards or factors identified below, in particular, could be clarified to improve their usefulness as indicators of an FHLBank's financial health or risk of failure.

#### **A. Current or anticipated declines in the value of assets held**

Current or anticipated declines in the market value of assets held by an FHLBank may not be an accurate indicator of such assets' underlying economic value. At any given time, the market value of assets may be subject to temporary illiquidity or market volatility. As such, any current or anticipated declines in the value of such assets could be temporary,

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<sup>7</sup> 12 C.F.R. §1229.11(a).

<sup>8</sup> Section 1255.4(a).

or may be accompanied by a decrease in liabilities, and might not represent any material risk to the financial health of the FHLBank. Recovery in the value of the asset also could occur rapidly. The risk of imposing an increase in temporary minimum capital requirements in these instances of temporary illiquidity or market volatility with respect to an FHLBank's assets could prove to be harmful to the FHLBank and to its membership given member sensitivity and concerns regarding additional capital calls. In particular, such a requirement could be pro-cyclical and lead to long-lasting declines in membership and business volume, furthering weakening the affected FHLBank. The FHFA should consider clarifying the nature and magnitude of the decline in the value of assets that would warrant an order to temporarily increase minimum capital levels.

### **B. Compliance with regulations, written orders, or agreements**

The FHFA should consider clarifying the standard related to compliance with regulations, written orders and agreements to apply only to material non-compliance with such regulations, written orders or agreements that negatively impact an FHLBank's financial health or that are indicative of its potential risk of failure. Without clarification, it would appear that any violation of any regulation, order or agreement could permit the FHFA to order an FHLBank to increase temporarily its minimum capital levels.

### **C. Housing finance market conditions**

We request that the factor related to housing finance market conditions be deleted because it is not relevant to the FHLBanks except to the extent that housing finance market conditions result in substantial decline in the value of housing-related assets held by the FHLBanks. That situation, however, is covered in proposed §1225.4(a)(1).

### **D. The ratio of the market value of equity to the par value of capital stock**

As an introductory matter, we observe that the inclusion at this time of a market value of equity ("MVE")/ par value of capital stock ("PVCS") ratio in determining capital adequacy appears to run contrary to the FHFA's recent comments on the subject. In the final capital classification rule issued just eight months ago,<sup>9</sup> the FHFA indicated it would "continue to weigh whether it would be appropriate to propose a separate target for retained earnings and/or MVE/PVCS, either as a stand-alone regulation or as part of any risk-based capital proposal."<sup>10</sup> The FHFA declined at that time to weave MVE/PVCS into the capital classification analysis. We are unaware of any subsequent FHFA rulemaking, guidance, analysis or pronouncements concerning the utility and applicability of MVE/PVCS.

Without analytically supported guidance, it is difficult to judge fully the appropriateness of using MVE/PVCS as a factor in determining an FHLBank's minimum capital requirement. Equally important, neither the FHLBanks, their member institutions nor

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<sup>9</sup> 74 Fed. Reg. 38508 (August 4, 2009).

<sup>10</sup> *Id.* at 38510. In that rulemaking, many commenters, including certain of the FHLBanks, expressed concern about using MVE in a similar context, and no commenter supported using an MVE/PVCS measure as part of the defining criteria (for a proposed, but not adopted, "well-capitalized" classification) or as a separate capital requirement.

other stakeholders would be able to determine ahead of time with any certainty— perhaps not until after a temporary order has been issued— how the FHFA applies this factor on an ongoing basis.

Given that the FHFA has now asserted this factor may be important relative to minimum capital requirements, the current rulemaking would be well-served if the FHFA— consistent with its recent statements— would detail its thinking, including the results of any studies or analysis it has conducted, on how this factor should be defined and applied. This would permit the FHLBanks and other stakeholders to respond to the proposed meaning and scope of the provision before a final rule is issued. The FHFA should discuss in the context of its rulemaking process (i) how it would propose to define MVE (including during periods of severe market illiquidity) and (ii) why it is appropriate to use the MVE/PVCS ratio to determine whether an FHLBank’s minimum capital level should be increased. Specifically, the analysis should address the following questions:

- Is MVE for purposes of the temporary minimum capital regulation defined as set forth in 12 C.F.R. §932.5 (which establishes an FHLBank’s additional market risk risk-based capital charge) as the market value of total capital (defined as Class A stock, general allowance for losses, Class B stock and retained earnings) or otherwise?<sup>11</sup>
- Will MVE be defined in accordance with the liquidation value, or the going-concern value, of the FHLBank? The going-concern value would adjust for severely depressed asset values that result from market dislocations and illiquidity. If this term is defined to mean liquidation value, an inaccurate picture could emerge. Market conditions in the recent past revealed the distortions that may result from using MVE as a measurement of capital adequacy. The industry saw MVEs driven lower by discounts in securities prices that did not reflect real interest rate risk and that overstated credit risk.<sup>12</sup>

The answers to these questions are particularly important when an unspecified ratio could be applied— with very little notice and potentially significant adverse consequences— to an FHLBank that had previously been determined by the FHFA to be adequately capitalized. However, if the FHFA chooses to retain the MVE/PVCS ratio as a factor in the current rulemaking without first providing details of its analysis, then we urge the FHFA to use the release of the final rule to provide clear definitions and explanations of how this factor may be applied. For example, at what level(s) would or might the FHFA determine that this ratio is or has become a factor supporting an order increasing an FHLBank’s

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<sup>11</sup> See 12 C.F.R. §930.1 and 932.5 for definition of “total capital” and market risk capital requirement based on the relationship between market value of total capital to book value of total capital. Also, it is observed that adopting this as a factor for imposing a temporary minimum capital increase when the existing FHFA capital regulation already imposes an additional risk-based capital charge on any FHLBank that has a market value of total capital less than 85% of the book value of its total capital may result in “double charging” an FHLBank’s members capital for the same risk.

<sup>12</sup> It is observed that the pricing of at least some securities seems to be moving toward more typical levels.

minimum capital requirement?<sup>13</sup> Conversely, if such an order is already in place, how would this ratio have to change to support a conclusion by the FHFA that the temporary order should be rescinded?

We remain generally concerned with using MVE/PVCS as a factor for imposing a temporary minimum capital increase without consideration of the existing risk-based capital regulatory framework that already takes this relationship into consideration to some extent in establishing an FHLBank's risk-based capital requirements. We believe that imposing MVE/PVCS as a factor should be considered as part of a comprehensive risk-based capital rulemaking in which the FHLBanks, their members and other stakeholders are provided with sufficient time and opportunity to thoughtfully consider and comment on this critical issue.

#### **E. Other conditions as detailed by the Director**

The FHFA should provide some guidance as to what other conditions might be relevant in determining whether to impose temporary increases in minimum capital levels on an FHLBank, and provide the FHLBanks a chance to comment on any new proposed standards.

#### **F. Written plan to augment capital**

The requirement that an FHLBank submit a written plan to augment capital is not a standard or factor, but rather a procedural requirement that the Director may impose. Thus, it should be separated from the standards and factors set forth in proposed section 1225.4(a).

### **IV. Promulgation of Future Guidance**

The proposed rule provides that the FHFA may provide guidance regarding the standards or procedures contained in the rule from time to time.<sup>14</sup> To the extent that any such guidance, including any elaboration, refinement, or new information issued under this proposed section, represents rulemaking, we believe that such guidance should be subject to the rulemaking requirements of the Administrative Procedure Act ("APA") and request that the FHFA provide the FHLBanks and their members with the opportunity to comment thereon.

The APA requires each agency to publish in the Federal Register "(D) substantive rules of general applicability adopted as authorized by law, and statements of general policy

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<sup>13</sup> While it may not be possible, given the circumstances, to establish a bright-line ratio, below which this factor would be triggered, the FHFA could help clarify this standard by addressing such issues as the size of a fluctuation that would weigh significantly in favor of the issuance or rescission of a temporary order.

<sup>14</sup> Proposed section 1255.4(d) (stating, that "[t]he Director may determine, from time to time, [to] issue guidance to elaborate, to refine or to provide new information regarding standards or procedures contained herein.")

or interpretations of general applicability formulated and adopted by the agency.”<sup>15</sup> The definition of “Rule” includes an agency statement designed to interpret law or policy.<sup>16</sup>

Proposed §1255.4(d) should be treated in the same manner as the proposed rule since it gives the Director the authority “to elaborate, to refine or to provide new information regarding standards or procedures contained [in the regulation]” and purports to give the Director the authority to change or “refine” a regulation subject to the APA. Any elaboration, refinement or new information issued pursuant to proposed §1255.4(d) would be used to “interpret” law or policy, and therefore, should be considered subject to notice and comment as required by the APA.

The APA requires that a “general notice of proposed rulemaking shall be published in the Federal Register... .” 5 U.S.C. §553(b). However, the subsection does not apply “(A) to interpretative rules, general statements of policy, or rules of agency organization, procedure, or practice; or (B) when the agency for good cause finds (and incorporates the finding and a brief statement of reasons therefor in the rules issued) that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest.” *Id.* Although it could be argued that the guidance that the Director may issue under proposed §1255.4(d) is an “interpretative rule” or a “general statement of policy,” 5 U.S.C. §552(a)(1)(D) would still require such guidance to be published in the Federal Register for public comment to the extent that it is substantive. Since the proposed standards and factors for imposing a temporary increase are broad and general, and the effect of a temporary increase in an FHLBank’s minimum capital requirement is a substantive matter for an FHLBank’s members with respect to knowing how much capital they will be required to contribute to their FHLBank, we believe that any guidance would go beyond merely “interpreting” the rule or providing “general statements of policy.” Rather, such guidance would constitute “substantive rules of general applicability” which could significantly impact the operations of an FHLBank and also may create substantial funding obligations for member institutions under an FHLBank’s capital plan. Therefore, we request that the FHFA recognize that guidance issued pursuant to this proposed rule is subject to the general notice provisions of 5 U.S.C. §553(b).

Based on the foregoing, we respectfully request that the FHFA remove proposed §1255.4(d) from the regulation. In the event that the FHFA finds it necessary “to elaborate, to refine or to provide new information regarding standards or procedures contained [in this regulation],” we encourage the FHFA to do so pursuant to the notice and comment procedures established by the APA. In particular, since actions taken under the proposed rule could possibly require member institutions to contribute more capital to an FHLBank or have the contingent liability of doing so, the FHLBanks, their members and other stakeholders should be given notice and opportunity to comment pursuant to the APA.

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<sup>15</sup> 5 U.S.C. §552(a)(1).

<sup>16</sup> 5 U.S.C. §551(4).

V. Conclusion

Again, we thank you for the opportunity to provide comments on this important matter for the FHLBanks and their member-shareholders. While we believe that this proposed rule is necessary and important, we urge you to consider the comments in this letter and revise the final rule to incorporate our concerns.

Sincerely,

**Federal Home Loan Bank of Atlanta**



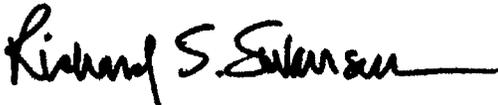
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