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National Association of Federally-Insured Credit Unions

August 31, 2017

Alfred M. Pollard
General Counsel
Federal Housing Finance Agency
400 7th St., SW, 8th Floor
Washington, D.C. 20219

RE: Federal Home Loan Bank Capital Requirements (RIN 2590-AA70)

Dear Mr. Pollard:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), the only national trade association focusing exclusively on federal issues affecting the nation's federally-insured credit unions, I am writing to you in regard to the Federal Housing Finance Agency's (FHFA) proposed rule to amend Federal Home Loan Bank (FHLB) capital requirements. NAFCU acknowledges that the FHFA is taking steps to modernize the nearly two decades-old regulation governing FHLB risk-based capital requirements to align with the requirements of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (Dodd-Frank Act). NAFCU would like to offer the following recommendations regarding the FHFA's proposed rule to minimize any potential negative consequences, especially as Congress begins to tackle proposals for housing finance reform:

(1) Treat all government-sponsored enterprises (GSEs) equally with respect to unsecured credit exposure limits, regardless of whether they receive capital support or assistance from the United States government;
(2) Retain the current credit risk percentage requirement for advances the FHLBs make to their member institutions; and
(3) Replace the FHFA's explicit authority to require changes to the FHLBs' capital charges for specific assets with the authority to recommend revisions to the FHLBs' methodology for credit risk ratings.

General Comments

In 1999, the *Gramm-Leach-Bliley Act* (GLBA) amended the *Federal Home Loan Bank Act* (Bank Act), under which the eleven FHLBs are organized, to replace the subscription capital structure of the FHLB system and authorize the FHLBs to issue new Class A and Class B stock. The GLBA also amended the Bank Act to impose new total, leverage, and risk-based capital requirements and directed the Federal Housing Finance Board (Finance Board) to adopt regulations prescribing uniform capital standards for the FHLBs. The Bank Act requires the FHLBs to meet a risk-based capital requirement by maintaining certain amounts of permanent capital, under the 2001 Finance Board regulations, and directs the FHLBs to calculate a credit risk capital charge for each of its assets, off-balance sheet items, and derivative contracts. The charge is generally based on the book value of an asset multiplied by a credit risk percentage requirement (CRPR) for that asset or item, which is based on one of the tables in the rule.

The FHFA is proposing to adopt, with amendments, the regulations of the Finance Board regarding the capital requirements of the FHLBs. The proposed rule carries over most of the regulations without material change, but would substantively revise the credit risk component of the risk-based capital requirement and the limitations on extensions of unsecured credit. Section 939A of the Dodd-Frank Act mandates that federal agencies review regulations that require the use of an assessment of the creditworthiness of a security or money market instrument and remove any references to or requirements based on ratings issued by a Nationally Recognized Statistical Rating Organization (NRSRO). Some of the provisions of the Finance Board regulations that contain requirements based on NRSRO ratings are the credit risk capital charges for certain FHLB assets and the unsecured credit limits for the FHLBs. The FHFA is proposing to amend part 1277 of its regulations by adopting the Finance Board regulations, located at 12 C.F.R. Part 932, and amending the above provisions, among others, to bring them in compliance with the Dodd-Frank Act.

Although NAFCU generally supports the FHFA's efforts to bring the FHLB capital requirements into compliance with the Dodd-Frank Act, NAFCU has several suggested changes to the FHFA's proposed rule. More specifically, certain aspects of the proposed rule, as detailed below, may put the FHLBs' investment abilities at risk, impact the pricing of advances, and lead to inconsistent treatment of FHLB assets. NAFCU requests that the FHFA work closely with the FHLBs to ensure that any proposed changes do not have unintended consequences on the safety and soundness of the FHLB system.

Unsecured Credit Exposure Limits

The FHFA proposes to amend the special limits for GSEs on unsecured extensions of credit. Proposed Section 1277.7 would apply a special limit for only those GSEs operating with capital support or other form of direct financial assistance from the United States government, including the financial support currently provided by the United States Department of the Treasury under the Senior Preferred Stock Purchase Agreements. For such GSEs, the proposed rule sets the unsecured credit limit at 100 percent of an FHLB's capital. Under the proposed rule, the credit limit for any other GSE, other than another FHLB, would be the same as any other counterparty without a government charter, likely 15 percent (determined to have an FHFA 1 rating) based on proposed Table 1 to Section 1277.7. Under the current FHFA regulations, FHLBs may invest up to 100 percent of their total capital in GSE obligations, regardless of whether the GSE receives capital support or other financial assistance from the United States government. The proposed rule draws an unwarranted distinction between GSEs based on their ability to repay obligations.

This distinction inhibits the FHLBs' ability to safely invest excess liquidity in high-quality, liquid GSE obligations. As a result, the FHLBs would have more difficulty readily accessing the funds they need to provide advances to their members. Additionally, if implemented, the FHLBs would no longer be able to safely invest their excess liquidity at a reasonable rate of return, which could have a negative impact on advance pricing and dividends rates for FHLB members.

The FHFA's proposed rule also ignores the effect that future housing finance reform may have on the capital support of GSEs. If Congress were to adopt a reform proposal to restructure Fannie Mae and Freddie Mac so that they continue to be GSEs but their direct support from the United States government is terminated, this proposed special limit would no longer apply. This could have a profound impact on the housing finance system. When finalizing this rule, NAFCU urges the FHFA to consider all of the possibilities in such a scenario, especially with respect to the potential effects this portion of the proposal may have on the FHLB system and its members. NAFCU supports a continuation of the current FHFA regulations, which treat all GSEs the same for purposes of unsecured credit exposure limits.

Credit Risk Percentage Requirements for Advances

Section 1221.4(f) of the proposed rule would carry over existing Table 1.1, which establishes CRPRs for advances. Table 1.1 would maintain the same four maturity categories for advances but increase the CRPRs for each category. The FHFA acknowledges that an FHLB has never experienced a loss on an advance to a member, yet inexplicable decides to increase the CRPRs for advances. This, in turn, increases the credit risk charges for all advances, especially those with longer maturities. Even though this slight increase in CRPRs is not likely to have a dramatic impact on the FHLBs' overall risk-based capital requirements, the increase would certainly create a disincentive for longer-term advances and would likely have a negative impact on pricing for such advances. NAFCU suggests that the FHFA retain the current CRPRs in Table 1.1 so that pricing for advances remains consistent and the FHLBs can continue to provide this valuable and low-risk asset to their members.

FHFA Authority to Change Capital Charges

Proposed Table 1.2 to Section 1277.4 outlines the requirement for internally rated non-mortgage assets, off-balance sheet items, and derivatives contracts. The proposed rule also contains a provision that permits the FHFA, on a case-by-case basis, to evaluate an FHLB's credit rating methodology and if it identifies a deficiency in the FHLB's methodology, then it may direct the FHLB to change the calculated credit risk capital charge for that asset, item, or contract. This provision essentially establishes an automatic validation of the FHFA's position in a disagreement with an FHLB regarding its credit risk rating methodology. Disagreements with an FHLB should be handled through a transparent procedure whereby the FHFA recommends changes to the FHLB's methodology instead of simply directing the FHLB to change the calculated credit risk capital charge for a certain asset. Directing such changes to capital charges could lead to inconsistencies in the treatment of assets across the FHLB system and would create uncertainty and unpredictability. NAFCU suggests the FHFA revise this portion of the proposed rule to avoid such potential consequences and to protect the stability of the FHLB system.

Conclusion

NAFCU appreciates the opportunity to provide comments regarding the FHFA's proposed rule to amend FHLB capital requirements. If you have any questions or concerns, please do not hesitate to contact me at (703) 842-2212 or akossachev@nafcu.org.

Sincerely,

Ann Kossachev
Regulatory Affairs Counsel