

FHLBoston

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By e-mail to RegComments@FHFA.gov

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Federal Housing Finance Agency
Fourth Floor
1700 G Street, N.W.
Washington, D.C. 20552

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”). 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 Section 1201 of the Housing Economic and Recovery Act of 2008

As drafted, the proposed rule would seem to apply to the FHLBanks and the Enterprises with little consideration of the differences between them. For example, the FHLBanks are, at a minimum, distinguishable from the Enterprises based on the fact that the FHLBanks are cooperatives that issue subscription-based redeemable capital stock at par and do not issue publicly-traded permanent equity securities at market. These distinctions give rise to significant differences between the FHLBanks and the Enterprises in terms of their respective abilities to raise capital. We believe that the FHFA should take into account these and other differences in drafting the final rule.

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

The proposed rule states that the Director of the FHFA (“Director”) 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.¹ An FHLBank would then have

¹ Section 1225.3

15 days to provide the FHFA with comments or objections to the temporary increase, after which, in the absence of any response or further action by the Director, the original notice would take effect at the end of the original 30-day notice period.² Most of the FHLBanks have issued Class B and/or Class A stock to members in accordance with capital structure plans that specify notice requirements prior to the effective date of changes to stock investment requirements. To avoid potential conflicts between the proposed rule and the FHLBanks' capital structure plans, we suggest that, in its final rule, the FHFA reference that the FHLBanks will be required to comply with the terms of their respective capital structure plans (including notice periods) in regards 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..."³ 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 a regulated entity.⁴ As a threshold matter, we believe that the use of the term "standards" implies that there may be objective, quantifiable measures that might be applied to each of the factors listed when determining whether or not to impose a temporary increase in minimum capital. If such standards exist, we believe they should be specified in the rule. However, the proposed rule enumerates no such measures that would apply to each of the factors.

We 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.

² Unless the Director determines that an exigency exists, in which case the time periods could be shortened.

³ 12 C.F.R. §1229.11(a)

⁴ Section 1255.4(a)

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

Current declines in the market value of assets held by a regulated entity 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 declines in the value of such assets could be temporary and might not represent any material risk to the financial health of the regulated entity. 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 a regulated entity'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 lead to long-lasting declines in membership and business volume, furthering weakening the affected FHLBank.

Moreover, the concept of basing a temporary increase in the minimum capital requirements of an FHLBank on 'anticipated' declines is hard for us to understand as it is generally recognized that it is not possible to predict market movements and future prices.

The FHFA should consider limiting this factor to current declines in the market value of the assets and 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 this standard to apply to material non-compliance with 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 temporary minimum capital levels.

C. The ratio of the market value of equity to the par value of capital stock

The rule should clarify the definition of the market value of equity (MVE) by reference to 12 C.F.R. §932.5. Notwithstanding this suggestion, and consistent with our comment regarding our concerns about the use of market values more generally, we believe that such an indicator should be applied with caution to avoid undue hardship on FHLBanks and their members.

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.

D. Written plan to augment capital

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

IV. Conclusion

Again, we thank you for the opportunity to provide comments on this important matter for the FHLBanks and their member-shareholders. We urge you to consider the comments in this letter and revise the final rule to incorporate its concerns.

Sincerely,



Edward A. Hjerpe, III
President & Chief Executive Officer