



REGULATORY INTERPRETATION 2001-RI-01

Date: January 12, 2001

Subject: Authority of the Office of Finance to Reopen Consolidated Obligations

Request Summary:

The Office of Finance (OF) seeks an interpretation of the Federal Housing Finance Board (Finance Board) regulations, specifically 12 C.F.R. § 966.2, and Finance Board Resolution Number 2000-44 (Nov. 30, 2000) that after December 31, 2000 the Federal Home Loan Banks (Banks), acting through the OF as their agent, are authorized to issue consolidated obligations (COs), including both bonds and discount notes, through the reopening of COs previously issued by the Finance Board through the OF as its agent.

Background:

In its request, the OF states that, in the ordinary course of business, when making CO issuance determinations, the OF sometimes will prefer to “reopen” an outstanding issuance of COs, thus increasing the amount outstanding, rather than issue a new series of COs. If the interest rate, maturity date, and other terms and conditions on a prospective bond issue are very similar to an existing bond issue, the OF may find it convenient and economical to reopen the bond issue by combining the new bond issue with the existing similar bond issue. The benefit of reopening debt is to allow for larger and thus more liquid bond issues. This added liquidity should lead to a modest reduction in the interest cost of the bond and should reduce the Banks’ overall funding costs.

The OF has at least two programs where reopening debt has been a particularly important tool: the so-called “TAPS” program and the global debt program. Global bonds are single bond issues of \$1 billion or more. This compares with an average issuance size in the domestic program of well under \$100 million. Because one aim of the global debt program is to create large issues that are actively traded, the OF occasionally reopens an existing global debt issuance to increase its size and enhance its liquidity instead of issuing a new global bond.

Since mid-1999, the Finance Board has issued a large portion of its fixed-rate, non-callable (bullet) debt through the OF in a program known as TAPS. The standard TAPS maturities are 2, 3, 5, 7 and 10 years. During a three-month period, all bullet debt in each of these maturities is combined into a single maturity-specific CUSIP number. In this way, for example, there is a single large two-year bond at the end of the three-month period instead of 50 or more smaller, less liquid issues. In its request, the OF states that it regularly reopens outstanding TAPS issuances to tap investor demand for the greater liquidity of COs that are part of a larger, single issue. Additionally, the OF may find it more economical to reopen an old TAPS bond, which would have a remaining maturity the same as the prospective new bond issue, rather than to issue a new TAPS bond. For example, it may be more economical to reopen one-year-old TAPS bond with an original three-year maturity than to issue a new two-year TAPS bond.

There are a number of practical limitations on the extent to which the OF can reopen issues. First, reopening generally will work only with bullet debt, and bullet bonds are only 40 percent of outstanding bonds. Second, the original issue discount (OID) rules of the Internal Revenue Service of the United States Department of Treasury effectively require that the interest rate on the reopened bond and the interest rate on the prospective bond be very close. Third, most of the debt issued by the Finance Board under the authority of section 11(c) of the Federal Home Loan Bank Act (Bank Act) will roll off within a few years because there is relatively little long-term Bank bullet debt.

Prior to January 1, 2001, the Finance Board (or its predecessor agency) issued, through the OF, all COs pursuant to section 11(c) of the Bank Act, 12 U.S.C. § 1431(c) (the predecessor agency also issued COs under section 11(b) of the Bank Act in the first half of the twentieth century). In practice, the Finance Board annually promulgated a resolution governing the authority of the OF to issue COs under section 11(c) of the Bank Act based on anticipated Bank needs. The Finance Board's annual authorization expired by its own terms on December 31, 2000.

On June 7, 2000, the Finance Board amended its regulations governing the issuance of COs to authorize the Banks to issue COs through the OF acting as agent of the Banks under section 11(a) of the Act. *See* Finance Board Res. No. 2000-24 (June 2, 2000), 65 Fed. Reg. 36290 (June 7, 2000), (Final Rule) and 12 CFR parts 966, 985 and 989. The expressed purpose of the Final Rule was to transition the Finance Board out of the issuer role and position the Banks as both the joint obligors and issuers of the COs. Importantly, the revised debt issuance process was designed to reflect the reality of the Banks' funding operations by allowing the Banks to access the capital markets through the OF to fund their operations, and it was consistent with the congressionally mandated devolutionary trend granting the Banks greater autonomy in the management of their business functions. The Finance Board and the OF staff expected that all COs issued after that date would be issued by the OF as agent for the Banks under the authority of section 11(a) of the bank Act and applicable provisions of the Final Rule.

Because of the self-terminating nature of the then-existing debt issuance delegation, and in response to a question concerning the TAPS program debt, the Finance Board adopted Finance Board Resolution Number 2000-44 on November 30, 2000 (Resolution) to clarify the OF's authority under section 11(a) of the Bank Act to reopen outstanding COs. The Resolution authorizes the OF to reopen any COs issued on behalf of the Finance Board pursuant to section 11(c) of the Bank Act and section 985.2(b)(2) of the Finance Board's regulations (or any predecessor provisions). The Resolution describes the imminent expiration of the then-existing delegation from the Finance Board to the OF to issue COs on behalf of the Finance Board, and states that the "Finance Board wishes to continue to be able to reopen these, or any other COs, as necessary, pursuant to section 985.2(b)(2) of the Finance Board's regulations and section 11(c) of the Bank Act;" as reasons for adopting the Resolution.

The OF requests that, in order to reduce the possibility of market confusion, simplify the issuance process, help ensure a smooth and seamless transition of the CO issuance process between the Finance Board and the Banks and help ensure that the capital markets treat all COs similarly regardless of which entity may have been the issuer of the CO, the Finance Board should interpret the Resolution to allow the OF to have the "flexibility to treat all COs issued after the transition date as having been issued by the OF as agent for the Banks, even if they are technically reopenings of COs issued by the Finance Board prior to the transition," and that the OF not be required to treat all such reopenings as completed under section 11(c) of the Bank Act.

Analysis:

Under section 11(a) of the Bank Act, the authority of the Banks to issue debt (including reopening of such debt issuances) is expressly subject to the rules, regulations, terms and conditions the Finance Board may prescribe. *See* 12 U.S.C. § 1431(a) and 12 C.F.R. § 966.2(b)(1). The Finance Board adopted section 966.2(b)(1) to implement the Banks' authority under section 11(a) of the Bank Act to issue debt. The rule mandated that the Banks issue COs exclusively through the OF, 12 C.F.R. § 966.2(b)(2), required the Banks to be jointly and severally liable on COs issued under section 11(a) of the Bank Act, 12 C.F.R. §§ 966.2(b)(1) and 966.9, and expressly authorized the OF to undertake such issuance functions, 12 C.F.R. § 985.2(b)(1). As discussed above, the expressed purpose of the rule was to transition the Finance Board out of the issuer role and position the Banks as both the joint obligors and issuers of the COs.

A question arose in the context of the TAPS program because the TAPS quarters correspond to the Treasury refunding cycle and not to calendar quarters. Thus, the portions of a TAPS bond issued in November and December 2000 would have been issued by the Finance Board under section 11(c) of the Bank Act, but the January portions would be issued by the Banks under section 11(a) of the Bank Act in accordance with the transition provided for in the Final Rule. To clarify that the OF could reopen an existing TAPS bond on behalf of the Finance Board after December 31, 2000, the Finance Board adopted the Resolution, which expressly permits the OF to reopen TAP issuances or any other COs previously issued under section 11(c) of the Bank Act.

The OF would prefer not to have to distinguish reopened bonds by original issuance authority "to reduce (i) the possibility of market confusion, (ii) simplify the issuance process; (iii) help ensure that the market treats all COs similarly regardless of which entity(ies) nominally 'issued' the COs. .;" and to streamline and simplify disclosures in offering materials. The OF wishes instead to have the flexibility to treat all COs issued after the transition date as having been issued by the OF as agent for the Banks, including reopenings COs issued by the Finance Board prior to the transition.

Notwithstanding references in the "whereas" clauses of the Resolution to the delegation from the Finance Board to the OF to issue COs on behalf of the Finance Board, and to the Finance Board's wishes to continue to be able to reopen COs, as necessary, pursuant to section 985.2(b)(2) of the Finance Board's regulations and section 11(c) of the Bank Act; the Resolution itself is, and was intended to be, broadly permissive. The Resolution places no restrictions or conditions on the OF's ability to reopen debt previously issued by the OF as agent for the Finance Board. Given the Finance Board's clearly articulated intention in the Final Rule to effect a smooth and seamless transition of the CO issuance process from the Finance Board to the Banks and the OF as agent for the Banks, the requested interpretation of the Final Rule and the Resolution is reasonable.

The requested interpretation also would be consistent with the "savings clause" adopted as part of the Final Rule. *See* 12 C.F.R. § 966.10. That clause states in pertinent part:

Any agreements or other instruments entered into in connection with the issuance of COs prior to the amendments made to this part shall continue in effect with respect to all COs issued under authority of section 11(c) of the Act and pursuant to this part. References to consolidated obligations in such agreements and instruments shall be deemed to refer to all joint and several obligations of the Banks.

Interpretation

Pursuant to 12 C.F.R. § 966.2 and Finance Board Resolution Number 2000-44 (Nov. 30, 2000), the Banks, acting by and through the OF, may issue consolidated obligations – both bonds and discount notes -- pursuant to 12 C.F.R. § 966.2(b) through the reopening of consolidated obligations originally issued by the Finance Board, acting by and through the OF, pursuant to 12 C.F.R. § 966.2(a) or its predecessor regulation authorizing the issuance of consolidated obligations.

<p>A <u>Regulatory Interpretation</u> applies only to the particular transaction or activity proposed by the requestor, may be relied upon only by the requestor, and is subject to modification or rescission by action of the Board of Directors of the Finance Board. (See 12 C.F.R. § 907.5).</p>
