June 28, 2002

Mr. Alfred A. DelliBovi
President
Federal Home Loan Bank of New York
200 Park Avenue
New York, NY 10166-4193

NO-ACTION LETTER: Approval of New Business Activity Notice and No-Action Letter **(2002-NAL-05)**

Dear Mr. DelliBovi:

This responds to the notice of new business activity (Notice) filed by the Federal Home Loan Bank of New York (Bank) on June 11, 2002, regarding the Bank's proposal to execute a standby bond purchase agreement with the New York City Transitional Finance Authority (TFA), and the related request for a No-Action Letter filed on June 19, 2002. Through the proposed standby bond purchase agreement (SBPA) with the TFA the Bank would serve as a liquidity facility provider on a new TFA bond issue, the proceeds of which will finance restoration of portions of New York City destroyed on September 11, 2001.

Federal Housing Finance Board (Finance Board) staff reviewed the Notice and the Bank's request for a No-Action Letter. Finance Board staff also reviewed and considered the Bank's request for a regulatory interpretation filed on April 19, 2002 (and thereafter supplemented), and phone conversations, e-mails and other communications with the Bank's staff, all of which are related to the proposal described in the Notice. The staff hereby approves the Notice, subject to satisfaction of the conditions set forth below. This letter also constitutes the staff's No-Action Letter regarding regulatory limits on extensions of unsecured credit.

I. Review of the Proposal

A. Background on the TFA

The TFA is an independent public benefit corporation created by the New York State legislature in 1997 to issue obligations to finance a portion of the city's 10-year capital plan. TFA debt servicing is secured by future collections of city personal income taxes, with additional support from sales tax revenues if necessary. Revenues from city personal income taxes flow directly from the state comptroller to the TFA. The TFA retains city personal income tax revenues in an amount sufficient to service its debt and pay its operating expenses, and remits the remainder to the city. The TFA has no capital and no significant assets other than the statutorily pledged taxes and indenture related deposits.

On September 13, 2001, the TFA received authority to issue up to $2.5 billion of fixed and variable rate, tax-exempt bonds known as Restoration Bonds (R-Bonds).[1] Before this authorization, the TFA's debt authority was limited to $11.5 billion of mostly fixed rate, tax-exempt bonds. Approximately $9.5 billion of these previously authorized bonds are currently outstanding. To date, the TFA has issued $1 billion of the R-Bonds. The TFA is seeking liquidity facilities to support additional R-Bond series and satisfy liquidity and investor requirements. All of the R-Bonds will be subordinate to the $11.5 billion of previously authorized bonds and to the payment of TFA operating expenses.

B. Summary of the SBPA

The proposed SBPA will provide a liquidity facility for a series of variable rate, tax exempt R-Bonds with a total par value of $520 million (SBPA Bonds) that the TFA expects to issue in July 2002. Specifically, the Bank will commit to purchase bonds at par from the TFA's remarketing agent in the event any bondholders exercise their option to put the bonds to the agent and remarketing proceeds are not available to the agent. During the term of the SBPA the Bank will receive a quarterly commitment fee of 25 basis points per annum. The Bank will receive interest payments semi-annually on any SBPA Bonds it is required to purchase. The Bank expects that such interest payments will provide the Bank with an acceptable rate of return considering market conditions and the relative risks of the investment.

The Bank projects that the total amount of the Bank's "Available Commitment," as that term is defined under the SBPA, will not exceed $547 million. The Bank advised the staff that the total Available Commitment reflects the Bank's assumed purchase of all of the SBPA Bonds at par and the Bank's contemporaneous obligation to pay additional amounts for any interest accrued but unpaid on the purchased bonds. The Bank estimates that the maximum potential payment it would need to make for interest accrued but unpaid upon purchase of all the SBPA Bonds at any point during the term of the SBPA would be approximately $27 million.

The term of the SBPA will be five years, with an option exercisable by the Bank to extend the agreement for at least one year. The definitive SBPA will require that Standard and Poor's or Moody's Investors Services will rate the SBPA Bonds AA or better. If at any time the SBPA Bonds are downgraded below AA, the TFA will be required to either purchase a credit enhancement to raise the rating or secure another liquidity service provider to substitute for the Bank. The SBPA might have an event of default that terminates the SBPA if the SBPA Bonds are ever rated lower than A- by Standard and Poor's or A3 by Moody's Investors Service, or if the bonds ever become unrated.

If the Bank were called to purchase any of the SBPA Bonds, the Bank would be able to sell the bonds at par independently, or through the TFA's remarketing agent within a specified time of the Bank's purchase. If the Bank by either of these means does not sell any purchased SBPA Bonds, the TFA will be required to repurchase such bonds in five equal annual installments. Any SBPA Bonds in the Bank's possession upon expiration of the SBPA term or other termination of the SBPA will be exchanged for "refunding bonds" bearing the same coupon as the purchased bonds. On the exchange date the refunding bonds will carry a different cusip number but will in all other material respects have the same terms and conditions as the purchased bonds.

The Bank claims that there have been few instances involving issuers like the TFA where a bank has been required to purchase bonds pursuant to a liquidity facility such as the proposed SBPA. Nonetheless, the Bank asserts that if it is required to purchase any of the SBPA Bonds, the terms of the SBPA and the SBPA Bonds mitigate associated risks, and that the Bank will be able to manage associated risks.

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[1] Laws of New York, Chapter 297 (September 13, 2001).

Specifically, the Bank states that any credit risk associated with any purchased SBPA Bonds will be mitigated by the requirement that the TFA provide credit enhancements or an alternative liquidity facility. Liquidity risk will be mitigated by the Bank's ability to sell the bonds and by the TFA's obligation to repurchase any bonds the Bank is unable to sell itself.

The Bank further states that it has experience managing similar investments and instruments of substantial value. The Bank also notes that it has established a robust risk management framework consisting of seasoned staff, detailed policies and procedures and "Wall Street quality" analysis and modeling systems.

The Notice states that the proposed SBPA is illustrative of similar transactions in which the Bank might have a future interest. The Notice states that, over the long-term, the commitments related to such liquidity facilities could be up to $2 billion, but that the Bank's immediate interest is in the SBPA with the TFA. For the reasons stated below, this letter addresses the proposed SBPA only.

II. Staff Discussion and Analysis

A. Background on the Bank's Submissions

In the Bank's regulatory interpretation request the Bank asks for staff concurrence that: (1) the Bank has authority to execute the SBPA and purchase the SBPA Bonds, and (2) the R-Bonds are not unsecured credit for purposes of the Finance Board's unsecured credit regulation (UCR).[2] After filing the request for a regulatory interpretation, the Bank withdrew its second request and instead sought staff concurrence that the Bank's proposed Available Commitment of $547 million would be within the limits imposed by the UCR.

The Bank has asked for a prompt response from the staff so the Bank would be able to execute an SBPA with representations confirming the Bank's authority before the closing on the SBPA Bonds. The Bank filed the Notice after the staff advised the Bank of its view that the SBPA proposal would be deemed a new business activity subject to Part 980.[3] The Bank filed the No-Action Letter request after the staff advised the Bank that it would be more appropriate for the staff to issue a No-Action Letter, given the Bank's urgent timetable and the open issues regarding appropriate application of the UCR, discussed below.

B. Analysis

The Federal Home Loan Bank Act and Finance Board regulations allow Federal Home Loan Banks to invest in securities (including municipal bonds) as long as fiduciaries in the state where the bank is located have such authority under state law.[4] The Bank's submissions assert that fiduciaries in New York have authority to purchase TFA bonds under New York law. The Bank's submissions include an opinion of counsel that supports this assertion.

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[2] 12 C.F.R. § 932.9 (2002).

[3] 12 C.F.R. part 980 (2002).

[4] 12 U.S.C.A. § 1431(h) (2001); 12 C.F.R. § 956.2(f) (2002).

The Bank proposes a $547 million limit on its Available Commitment based on one of two formulas in the UCR that determine the limit on unsecured extensions of credit to a single counterparty. The particular UCR provisions upon which the Bank attempts to rely establish a dollar limit based on a percentage of the Bank's capital, which is keyed to a NRSRO rating on the obligation. The highest percentage-of-capital limit, 15%, applies to the highest rated obligations. The Bank claims that if these limits were applicable to the Bank and the R-Bonds were purchased today, the Bank would be limited to an investment of 14% of current capital, or approximately $547 million.[5] For this calculation the Bank assumes an initial rating of at least AA on the SBPA Bonds. The Bank requests an interpretation of the UCR that essentially would "lock-in" current UCR limits to any future SBPA Bond purchases, regardless of whether the Bank's capital diminishes in the interim and consequently decreases the limit that arguably would apply to any other contemporaneous extension of the same amount of unsecured credit for obligations having the same rating.

The Bank acknowledges that an issue arises as to the timing of the application of this UCR formula. In addition, the staff expressed to the Bank doubts about whether either of the formulas in the UCR apply to the proposed SBPA. Nonetheless, the staff is persuaded that applying the UCR formula to the proposed SBPA for the sole purpose of establishing a threshold on the Bank's Available Commitment is reasonable and consistent with the purposes of the UCR.

In addition, the staff believes that the proposed SBPA, and the Bank's commitment of $547 million, does not pose any material risk to the Bank's safe and sound operation. In particular, the staff notes that the NRSROs have given the TFA and its obligations consistently high ratings based on the TFA's strong debt service coverage, limitations on additional TFA debt, minimal bankruptcy risks, insulation from city and state fiscal stress, and legal and policy incentives to preserve bondholder rights.[6] The staff also notes that the Bank's current capital and risk-management resources, and the level of capital the Bank projects in its draft capital plan, are sufficient to cover and manage risks associated with the proposed SBPA.

C. <u>No-Action Position and Notice Approval Conditions</u>

The staff has determined not to initiate or recommend enforcement action against the Bank for violation of the UCR or any successor regulations as long as the Bank's total obligation under the SBPA (including the Bank's total Available Commitment and any related bond purchases, payments for unpaid accrued interest, exchanges for refunding bonds and associated expenses) does not exceed $547 million, and the Bank makes no additional extensions of unsecured credit to the TFA during the term of the SBPA.

In addition, the staff hereby approves the Notice, effective as of the date of this letter, subject to the following conditions:

1. The Bank shall submit to the staff as soon as they are available to the Bank:

   (a) A copy of the definitive SBPA, along with a term sheet describing key business terms (and cross-referencing those terms to the agreement) and highlighting any material changes from the draft SBPA filed with the Bank's submissions; and

   (b) A copy of the amended indenture reflecting the R-Bond authorization.

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[5] *See* 12 C.F.R. § 932.9(a)(3) (2002).

[6] *See, e.g.,* Fitch Ratings Report on the TFA's notes and bonds dated June 11, 2002.

2. The Bank shall notify staff of the Office of Supervision in writing promptly after the purchase of any SBPA Bonds that causes the Bank to exceed its unsecured credit limit calculated in accordance with section 932.9(a)(3) and (a)(4) of the UCR, or any successor regulation (notwithstanding paragraph (a)(1) of such section), as if such provisions were applicable to the Bank on the date of such purchase. The Bank's notice should include a brief description of the purchase and an analysis of relevant regulations.

The Approval of the Notice and staff's No-Action position stated herein apply to the proposed SBPA only. Neither the Approval of the Notice nor the No-Action position constitute staff approval to enter into any additional standby bond purchase agreements or similar liquidity facilities that would obligate the Bank to purchase any unsecured debt of the TFA or any other issuer.

The foregoing analysis, approval conditions and No-Action position are dependent on the facts, circumstances and assurances represented to staff in the Bank's submissions and other communications. Any material change in such facts, circumstances or assurances could nullify or require a modification of this letter. This letter expresses the position of staff only and may be modified or superseded by the Board of Directors of the Finance Board. If you have any questions, please contact the Director of the Office of Supervision.

Sincerely,

/s/ James L. Bothwell

James L. Bothwell
Managing Director