COUNCIL OF FEDERAL
HOME LOAN BANKS

2120 L Street, NW, Suite 208
Washington, DC 20037
202.955.0002 Tel
202.835.1144 Fax
www.fhlbanks.com

FHLBANKS
A NATION OF LOCAL LENDERS

April 15, 2010

Secretariat of the Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002
Basel, Switzerland

Re: Consultative Document: Strengthening the Resilience of the Banking Sector

Dear Sir or Madam:

I am submitting this comment on behalf of the Council of Federal Home Loan Banks, a trade association whose members are the twelve Federal Home Loan Banks. The Council of Federal Home Loan Banks appreciates the opportunity to comment on your recently published Consultative Document entitled "Strengthening the Resilience of the Banking Sector." Under separate cover, I have also submitted our comments regarding the Basel Committee's proposal for an international framework for liquidity risk in a separate comment letter.

The Federal Home Loan Bank System

The Federal Home Loan Banks (FHLBanks) are 12 regional banks, cooperatively owned and used by financial institutions serving America's communities to finance housing and economic development. Created by Congress, the FHLBanks and their members have been the largest and most reliable source of funding for community lending for nearly eight decades.

More than 8,100 lenders in the United States are members of the FHLBank System, representing approximately 80 percent of America's insured lending institutions. Community banks, thrifts, commercial banks, credit unions, community development financial institutions, and insurance companies are eligible for membership in the FHLBank System. Members have branches throughout the 50 states and the U.S. territories. Members range from some of the largest financial institutions in the world to banks with just a single branch.

The Federal Home Loan Bank System provides liquidity to its member institutions by making loans, called advances, to member institutions that are fully collateralized by member institution assets. These advances are used by member institutions to meet the mortgage and community lending needs of their local markets. The Federal Home Loan Banks and their members are the largest source of residential mortgage and community development credit in the United States.

The Council appreciates the need to strengthen the resiliency of the banking sector. As the recent upheaval in the financial markets clearly demonstrates, the current capital framework needs to be revisited in order to assure that banking institutions will have the resources necessary to withstand market turbulence. However, it is critically important for the Basel Committee to carefully weigh the impact of increased capital requirements on the economic recovery, and the aggregate effects of the Basel Committee's proposal along with the numerous other regulatory and accounting changes that are currently under discussion or being implemented. Unless these interrelated proposals are coordinated and considered jointly these proposals could significantly undermine economic recovery and the health of our financial system

In addition to this general comment, the following are some specific issues of concern to the Council:

1. Increased Capital For Certain Credit Exposures

The proposal raises the capital requirements for a banking organization's credit exposures to counterparties in derivative transactions, repurchase agreements, and securities financing arrangements. The Basel Committee is also proposing to increase the risk-weights assigned to exposures to other financial institutions. The Federal Home Loan Banks are extensive "end users" of derivative contracts, especially interest rate swap agreements. These agreements protect the Banks from interest rate risk, and allow the Bank to match the funding needs of its members with the exposure of the Banks to the credit markets. The Banks are prohibited by regulation from engaging in speculative derivative transactions. The proposal could unnecessarily increase the cost to the Banks for engaging in these swap agreements, thereby raising the cost of funding for our members. In addition, due to the need to match the swaps with the funding needs of our members, it is impractical (primarily due to the embedded optionality within the advances and the underlying mortgage collateral) for the Banks to use standardized swap agreements that would be required to clear through a clearinghouse. The Council therefore urges that the Basel Committee not impose higher capital or other costly requirements with regard to derivative contracts, including those not cleared through a clearinghouse, that are entered into by end users, such as the Banks, and that are non-speculative and used solely for hedging purposes.

2. Leverage Ratio

The proposal would impose a leverage ratio standard on banking organizations, but unlike the standard used in the United States, it would include certain off-balance sheet items in the denominator. In determining total assets, there would be no recognition of collateral or guarantees and netting of exposures would not be allowed. In addition to other considerations, we expect this to encourage the clearing of derivatives through a central clearinghouse. As explained above, Federal Home Loan Banks engage in derivative transactions that are tailored to match specific exposures, and thus are not suitable for clearing through a clearinghouse. This proposal will make it difficult, if not impossible for banking organizations to enter into these swap agreements with a Federal Home Loan Bank. For the reasons explained above, this should be modified.

3. Reducing Procyclicality and Promoting Countercyclical Buffers

The Basel Committee's proposal would require banking organizations to hold a capital buffer that is in excess of minimum capital requirements. Banks that fall below the required buffer would not be "undercapitalized," but would be subject to restrictions on dividends, share buy-backs, and staff bonus payments. Further, the size of the buffer would be adjusted upwards during periods of excessive credit availability to prevent the formation or continuation of asset bubbles. The Council is concerned that if this proposal is adopted banks would feel it necessary to hold a capital buffer on top of the regulatory buffer, in order to ensure that the Government would not step in to prohibit dividends or adjust compensation. As a result, banking organizations may be forced to hold higher levels of capital than is justified by their risk. This will impede economic growth and could undermine the recovery presently underway.

4. Capital Surcharges of Systemically Important Financial Institutions

The Basel Committee is considering a capital surcharge on systemically important banking organizations, as well as a liquidity surcharge and other supervisory requirements. The Committee also proposes to increase the capital charges for exposures to large financial institutions, including off-balance sheet positions with these institutions. The Council believes that it is important that exposures to Federal Home Loan Banks should be not subject to these capital surcharges. Federal Home Loan Bank obligations are the joint and several obligations of all twelve Banks, and these obligations fully withstood the current financial problems without downgrade or impairment. Capital surcharges affecting these obligations will increase the cost of mortgage finance without a corresponding safety and soundness benefit. Similarly, increasing the capital charge for derivative and other collateralized exposures to Federal Home Loan Banks is not warranted, and would not be in the public interest.

The Council appreciates this opportunity to submit comments on the Committee's Consultative Document on strengthening the resilience of the banking sector. If you have any questions, please do not hesitate to contact me.

Sincerely,

John von Seggern
President and CEO