COUNCIL OF FEDERAL
HOME LOAN BANKS

FHLBANKS
A NATION OF LOCAL LENDERS

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

April 15, 2010

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

Re: Consultative Document: International Framework for Liquidity Risk Measurement, Standards and Monitoring

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 on Liquidity Risk.

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 the mortgage finance marketplace by making loans, called advances, to member institutions that are fully collateralized by mortgage-related 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.

As part of its function of providing funds for mortgage lending, the Federal Home Loan Banks also ensure liquidity for their members.

The recent liquidity crisis illustrated the importance of the FHLBanks. As other sources of liquidity disappeared, prior to the coordinated response of the Federal government, the FHLBanks increased their advances by 33% between year-end 2006 ($640B) and year-end 2008 ($928B), ensuring that their financial institution and other members had access to much needed liquidity provided in a safe and sound manner. In fact, a recent study by the Federal Reserve Bank of New York recognized the important role that the Federal Home Loan Bank System played, and the fact that the Bank System, not the Fed discount window, served as the primary source of liquidity for Bank member institutions.[1]

International Framework for Liquidity Risk Measurement, Standards and Monitoring

The Consultative Document proposing an International Framework for Liquidity Risk Measurement, Standards and Monitoring recognizes the crucial importance of liquidity in today's financial services markets. We commend the Basel Committee for recognizing the need for better methods to measure, monitor and control liquidity risks.

However, we have serious concerns that the proposal will negatively effect housing finance in the United States and reduce the availability of liquidity during times of economic turmoil. We believe that the new liquidity requirements will significantly impair the ability of our members to provide high quality, well underwritten mortgage products to the marketplace. The proposed liquidity requirements will effectively make access to the Federal Home Loan Bank System more expensive, and will thereby reduce the efficiency of this System. The proposal heavily discounts the fact that the Federal Home Loan Bank System is designed to act as a source of liquidity during economic downturns, and the proposal will have the unintended consequence of impairing the efficiency of the Bank System and thereby reducing the availability of liquidity for depository institutions participating in housing finance.

The Liquidity Coverage Ratio Proposal

As proposed, the "Liquidity Coverage Ratio would require our member depository institutions to have high quality, unencumbered liquid assets to survive a severe liquidity crisis lasting for up to 30 days. Assets that qualify toward meeting this liquidity test must be easily and immediately converted into cash with little loss of value. Further, the assets must be "unencumbered," meaning that they have not been pledged in any way to secure, collateralize, or enhance any transaction, other than assets that have been pledged to the Federal Reserve but not utilized.

[1] Federal Reserve Bank of New York, Staff Report No. 357 at page 2 (November 2008).

The Federal Home Loan Banks provide advances that are fully secured. Typically, the Bank secures current and future advances by taking a "blanket lien" on the residential and certain other assets of its borrower-members in excess of the actual amount pledged as collateral to support the outstanding advances. In fact, the blanket lien may cover all of the mortgage and other assets of a member.

However, it is important to understand that member banks can, usually with the consent of their Federal Home Loan Bank, and often do pledge assets not currently supporting Bank advances to other lenders, including a Federal Reserve Bank. When another lender perfects its security interest on such assets, that security interest, if created properly, will take precedence over the Bank's blanket lien. Further, these assets may be sold to another party without violating the blanket lien arrangement.

It is critically important that the members should not be penalized for these arrangements, and that collateral pledged, but not utilized for an advance, should also be recognized as available to meet the liquidity needs of the banking institution. We would also suggest that a member bank could receive "liquidity credit" to the extent that it has the ability to draw on further advances based on its current portfolio of eligible mortgage assets. The Federal Home Loan Banks have a long standing practice of being a reliable, prompt provider of advances to members based on each member's amount of pledged collateral. This is an on-going dynamic process. Effectively, this flexibility means that assets are not necessarily encumbered and should allow the member bank to still count the assets as available for liquidity.

In addition, we note that the Basel Committee is considering whether high quality corporate debt may be used to satisfy this liquidity standard. Consolidated Federal Home Loan Bank debt, which is jointly backed by all of the Federal Home Loan Banks, should be viewed as an acceptable asset for liquidity purposes without the need for a haircut. Federal Home Loan Bank debt is consistently rated AAA, and these debt instruments play a crucial role in the portfolio of many depository institutions. If these instruments are not allowed to fully count toward meeting the liquidity requirement, depository institutions will be motivated to replace these extremely safe investments with more risky obligations in order to offset the cost of complying with the new liquidity standard.

Net Stable Funding Ratio

The second new quantitative test proposed in the CP is the "Net Stable Funding Ratio." This is a test of the sufficiency of a bank's long term stable funding relative to the potential calls on the bank's resources, including calls from off-balance sheet exposures. The bank's long term liquidity needs are measured by assuming a stress scenario, such as a significant decline in the bank's profitability, a potential downgrade by a credit rating agency, or an event that calls into question the bank's reputation or credit quality of the institution

As currently proposed, a bank's "available stable funding" includes a percentage of the bank's stable deposits. However, no credit is given to Federal Home Loan Bank advances that are held by the bank, or to the fact that a bank may be eligible to draw down further advances provided it has eligible assets and otherwise meets the Federal Home Loan Bank stock requirements. We believe that the net stable funding ratio should be modified to reflect the stable funding that the Federal Home Loan Bank System provides to member institutions.

Under the net stable funding test, the amount of stable funding required is determined by assigning assets (and off-balance sheet exposures) a particular "required stable funding" ("RSF") factor. The more liquid the asset, the lower the RSF factor. In this regard we note that Federal Home Loan Bank System consolidated debt is extremely liquid and that a ready and deep market exists for these instruments. We would urge that the proposal recognize these characteristics of Bank System debt, and assign a commensurate RSF factor, which we believe should be close to, if not at 0 percent.

Finally, we note that the proposal suggests supervisory monitoring of the degree to which depository institutions are dependent upon a concentrated source of funding. In light of the special nature of the Federal Home Loan Banks, we believe that institutions should not be subject to criticism for relying on the Bank System to fund mortgage assets, especially during periods, such as now, when other sources of mortgage finance are limited.

Once again thank you for the opportunity to submit comments on your consultative document on liquidity risk.

Sincerely,

John von Seggern
President and CEO