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March 21, 2007

Communications Division
Public Information Room, Mail Stop 1-5
Office of the Comptroller of the Currency
250 E Street, S.W.
Washington, DC 20219
Docket No. 06-15

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, N.W.
Washington, DC 20552
Docket No. 2006-49

Ms. Jennifer J. Johnson, Secretary
Board of Governors of the Federal
Reserve System
20 Street and Constitution Ave., N.W.
Washington, DC 20551
Docket No. R-1238

Robert E. Feldman, Executive Secretary
Federal Deposit Insurance Corp.
550 17Street, N.W.
Washington, DC 20429
RIN No. 2064-AC96

Re: Risk-Based Capital Guidelines; Capital Adequacy Guidelines; Capital Maintenance: Domestic Capital Modifications 71 Fed. Reg. 77446 (December 26, 2006)

Dear Sir or Madam:

The Council of Federal Home Loan Banks is a non-profit trade association whose members are the twelve Federal Home Loan Banks. The Council is submitting this comment letter to bring to your attention an important issue raised by the Basel I-A notice of proposed rulemaking.

Under the existing risk-based capital framework (Basel I), the risk weight assigned to exposures issued or guaranteed by a Government Sponsored Enterprise (GSE), such as a Federal Home Loan Bank, is 20 percent. The preamble in the Basel I-A notice of proposed rulemaking [1]notes that two GSEs – Fannie Mae and Freddie Mac – as part of an agreement with their regulator, obtain and disclose credit ratings issued by a Nationally Recognized Statistical Rating

[1] 71 Fed. Reg. 77446 (December 26, 2006).

have IFS ratings. We believe that for a number of important policy and practical reasons the final regulation should not link capital risk weight assignments to independent financial strength assessments.

As a preliminary matter, we note that the Federal Home Loan Banks issue consolidated debt that is backed by the combined financial resources of the entire system. Individual Bank stock is not publicly traded, but rather is held only by member institutions and has a statutorily determined and fixed sale and redemption price. The Federal Housing Finance Board has extensive supervisory authority over the Banks, including the authority to approve new activities, establish risk-based capital standards, and approve each Bank's capital plans. In light of these and other factors, there is little, if any actual risk to investors holding consolidated debt instruments.

I. Inconsistency with the Goals of the Basel I-A Rulemaking

The use of IFS ratings for setting risk weights is inconsistent with one of the fundamental purposes of Basel I-A, to better align capital to the risks in a depository institution's portfolio. The IFS is not a measure of risk to the depository institution holding the asset. Rather, it is an attempt to measure the theoretical risk to the Government that is posed by the GSE's activities. The potential risk to the Government is not equivalent to the potential risk to holders of GSE securities, which is reflected in the normal credit rating assigned by the NRSRO (the "investor rating"). Put simply, the risk to the Government is not an appropriate basis for assigning risk weights to bank assets.

The proposal is also inconsistent with the agencies' goal of alleviating some of the competitive concerns that have been raised by some non-Basel II banks. These smaller banks are concerned that the potentially reduced capital requirements under Basel II may create competitive inequalities for non-Basel II banks holding similar assets. As noted in the preamble, one of the five principles guiding the Basel I-A issuance is to "minimize differences in capital requirements that may give rise to competitive imbalances between large and small banking organizations."

Under the advanced approaches authorized by Basel II, a bank holding GSE securities would not be required to align the holdings with an artificial IFS rating, but instead would use the *investor* credit rating, which appropriately relates to the risk to the bank holding the security. Under the Basel II advanced approach, the risk weight for GSE securities that have a rating of highest or second highest investment grade would be considerably *lower* than the 20 percent risk weight proposed for GSE securities in the Basel I-A NPR.[2]

[2] Depending on the investor credit rating, the risk weight for GSE securities with the first or second best ratings would be between 7 percent and 15 percent.