Federal Home Loan
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March 22, 2007

The Honorable Ben S. Bernanke
Chairman
Federal Reserve Board of Governors
20th and C Streets, NW
Washington, D.C. 20551

The Honorable John C. Dugan
Comptroller of the Currency
250 E Street, SW
Washington, D.C. 22019

The Honorable Sheila C. Bair
Chairman
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, D.C. 20429

The Honorable John M. Reich
Director
Office of Thrift Supervision
1700 G Street, NW
Washington, D.C. 20552

Re: Joint Notice of Proposed Rulemaking (NPR): Risk Based Capital Standards: Advanced Capital Adequacy Framework; and Joint NPR: Risk Based Capital Guidelines; Capital Adequacy Guidelines; Capital Maintenance: Domestic Capital Modifications.

On behalf of the Federal Home Loan Bank of Seattle (Seattle Bank) we thank you for the opportunity to comment on the proposed revisions to the risk based capital framework. The Seattle Bank is supportive of the development of risk based capital requirements for financial institutions to ensure the safety and soundness of such institutions and to help ensure that capital resources are optimized for the benefit of the nation's economy.

We are however concerned about two aspects of the proposals that could have a negative impact on the debt and equity of the Federal Home Loan Banks. Accordingly, we offer the following comments for your consideration:

The risk weighting for Federal Home Loan Bank consolidated obligations should be based on the credit ratings assigned by Nationally Recognized Statistical Ratings Organizations (NRSROs), not the individual financial strength (IFS) ratings of individual Federal Home Loan Banks.

The preamble to the Basel 1-A NPR states that the banking regulators are considering the use of IFS ratings to determine risk weights of for all government sponsored enterprise (GSE) obligations. We believe that for a number of policy and practical reasons the final regulation should not link capital risk weightings to IFS ratings:

- The use of IFS ratings is inconsistent with one of the fundamental purposes of the risk based capital requirements, to better align the capital to the risk of the financial institutions investments. Since all Federal Home Loan Banks are joint and severally liable for consolidated obligations, the IFS is not reflective of the risk to the depository institution holding the asset.
- Investors in Federal Home Loan Bank debt will demand an additional premium if the risk weight is determined by the IFS. The additional premium will be required whenever the IFS score translates into a risk weight in excess of 20 percent. However, even if the IFS score does not result in a higher risk weight, the fact that the risk weight may change in the future creates an uncertainty that will be reflected in market price. The premium will result in higher funding costs for GSEs, which will in turn raise the cost to the consumers of housing finance.
- The proposed alternative undermines the long-standing public policy instituted by Congress to assist the housing finance market by encouraging investments in GSE securities. For example, Congress has specifically authorized national banks and federal thrifts to invest in the obligations of housing GSEs (see 12 U.S.C. 24). This public policy of encouraging investments in housing GSEs would be undercut by a regulatory policy to make such investments more costly.

The agencies should clarify the risk weighting for investments in Federal Home Loan Bank capital stock.

The instructions for the preparation of Schedule U (Equity Exposures) states that the "aggregate adjusted carrying value of equity exposures to a Federal Home Loan Bank or Farmer Mac that are not publicly traded and are held as a condition of membership" are to be reported on the 20 percent risk weighting category. Other equity exposures to a Federal Home Loan Bank or Farmer Mac are reported in the 100% risk weight category.

It is not clear what the agencies mean by stock "held as a condition of membership." Federal Home Loan Bank members have membership stock purchase requirements and activity based stock purchase requirements. Are the agencies intending that only the membership stock be assigned a 20 percent risk weighting (which is typically a relatively small component of stock purchase requirements) or both membership and activity based stock requirements with only the excess stock receiving the 100 percent risk weight?

There is no difference in risk to the holders of required Federal Home Loan Bank stock or excess Federal Home Loan Bank stock. The different weighting appears to be an effort to penalize institutions that hold stock beyond that which is required for membership and activity. However, this matter has been addressed by the Federal Housing Finance Board by the issuance of a new regulation to limit excess stock (see 12 C.F.R. 925.23). Accordingly, we encourage the agencies to maintain the 20 percent risk weight for all Federal Home Loan Bank stock.

We appreciate the opportunity to comment on the proposed regulations. Please let us know if you have any questions or would like to discuss any of the comments.

Sincerely,

James E. Gilleran
President and Chief Executive Officer

Richard M. Riccobono
Executive Vice President and Chief Operating Officer