September 24, 2024

The Honorable Sandra L. Thompson
Director
Federal Housing Finance Agency
400 7th Street, SW
Washington, DC 20219

Dear Director Thompson:

The American Bankers Association[1] and the undersigned state bankers' associations are writing to share our concerns about recent and further expected changes to the Federal Home Loan Banks (FHLBs)' Credit Risk Management Frameworks.

On July 8, 2024, the Federal Home Loan Bank of New York issued significant updates to its Credit Risk Management Framework, aligning that framework with recommendations contained in the Federal Housing Finance Agency's (FHFA) FHLBank System at 100: Focusing on the Future Report (the Comprehensive Report).[2] These updates, which became effective on August 30, 2024, introduce a more rigorous Credit Risk Rating Framework for assessing the financial health of each member institution on a quarterly basis. Notably, these changes may restrict individual FHLB members' access to funding, especially during times of financial stress. There is concern that similar changes may soon be required of all eleven Federal Home Loan Banks.

While we recognize the FHFA's role as the regulator of the FHLBs and the appropriateness of requiring review and updates of credit rating frameworks, we have significant concerns about FHFA's imposition of new standards, without sufficient consultation and input from the banking industry, banking regulators, and other interested parties. Additionally, we are concerned about the confusion that has resulted from this process, leaving affected banks unable to fully understand the metrics being applied to them or the rationale for reduced borrowing capacity.

As we noted in our comments on the Comprehensive Review, the FHLBs have long served as an important source of liquidity for depository institutions, allowing banks to better serve their customers—including during periods of stress as they did during the 2007-2008 financial crisis and the early months of the pandemic, and the stress of March 2023. The FHLBs have also allowed banks to diversify their funding sources and access capital markets, increasing the safety and soundness of the banking system.

In the Comprehensive Report, FHFA indicated that:

> "The role of the FHLBanks in providing secured advances must be distinguished from the Federal Reserve's financing facilities, which are set up to provide emergency financing for troubled financial institutions confronted with immediate liquidity challenges. Due to operational and financing limitations of the market intermediation process, the FHLBanks

[1] The American Bankers Association is the voice of the nation's $23.9 trillion banking industry, which is composed of small, regional and large banks that together employ approximately 2.1 million people, safeguard $18.8trillion in deposits and extend $12.5 trillion in loans.
[2] https://www.fhfa.gov/programs/fhlbank-system-100

> cannot functionally serve as the lender of last resort, particularly for large, troubled members that can have significant borrowing needs over a short period of time. To address this, the FHLBanks should coordinate with their members' primary regulators and the regional Federal Reserve Banks to ensure financial institutions' borrowing needs continue to be met when they no longer meet the FHLBanks' credit criteria."

That viewpoint, as well as the recent Request for Input from FHFA regarding efforts being considered by FHFA to shift the mission away from liquidity toward more affordable housing efforts, runs counter to Section 306(d) of the Competitive Equality Banking Act of 1987 (CEBA) which recognizes the FHLBs as a "lender of last resort." [3]

Taken together, the language of the report, the mission RFI, and the apparent required changes to the credit framework, suggest that the FHFA is seeking to reduce the FHLBs' role as a key liquidity source, and may be ignoring the will of Congress as reflected in CEBA in the process.

An abrupt and unexpected reduction in FHLB liquidity provision is problematic because of the critical role the FHLBs play for the banking system, particularly smaller institutions.[4] Any changes impacting the FHLB's role of liquidity provider, or its statutorily recognized role as lender of last resort, will have significant consequences for banks and the customers and communities they serve. Therefore, contemplation of changes must not be undertaken lightly nor in a vacuum. Sudden unilateral changes that curtail the FHLBs' ability to provide liquidity risks creating an unexpected funding gap for depositories that cannot be filled easily or without great cost.

Banks are continuing to ensure they have a variety of day-to-day and contingent funding sources, including being ready and able to use the discount window. For its part, the Federal Reserve has only recently issued a request for input for improving discount window operations. Keeping in mind that the FHLBs have different capabilities and functions and are therefore not interchangeable, the discount window needs significant improvement before it is efficient for banks of all sizes to use.

Given these interwoven and complex issues, we urge both greater transparency and a more deliberative approach to changes that will effectively reduce FHLB members' borrowing capacity, including publishing for notice and comment any proposed changes to the credit framework requirements for the FHLBs. In addition, we request an opportunity to discuss how FHFA is approaching these issues, the degree to which FHFA is coordinating and collaborating with the prudential regulators, and engagement with industry both to better understand and to have a voice in the decision-making process given the great importance of any potential changes to our members and the communities they serve.

The American Bankers Association would be pleased to coordinate a meeting or facilitation of other industry engagement. Please contact Joseph Pigg, ABA Senior Vice President and Sr. Counsel at JPigg@aba.com or 202-663-5480 to assist.

Thank you.

American Bankers Association

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[3] https://www.congress.gov/100/statute/STATUTE-101/STATUTE-101-Pg552.pdf
[4] Fed RFI on Discount Window

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Arizona Bankers Association
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Connecticut Bankers Association
DC Bankers Association
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