

12. Amend § 933.2 by redesignating paragraphs (e)(4), (e)(5) and (e)(6) as paragraphs (e)(5), (e)(6) and (e)(7), respectively and by revising paragraph (e)(3) and adding new paragraph (e)(4) to read as follows:

§ 933.2 Contents of plan.

* * * * *

(e) * * *

(3) Shall specify whether the stock of the Bank may be transferred among members, and, if such transfer is allowed, shall specify the procedures that a member should follow to effect such transfer, and that the transfer shall be undertaken only in accordance with § 931.6 of this chapter;

(4) Shall specify that the stock of the Bank may be traded only between the Bank and its members;

* * * * *

13. Add new § 933.5 to read as follows:

§ 933.5 Disclosure to members concerning capital plan and capital stock conversion.

(a) No capital plan shall become effective until disclosure meeting the requirements of Item 11(a) through (d) and Item 12(a) through (e) of Schedule 14A of the Securities and Exchange Commission's (SEC's) rules (17 CFR 240.14a-101, Items 11 and 12) (Proxy Statement Disclosure) and of paragraph (b) of this section has been provided to members. All disclosure required under this section shall be transmitted, sent or given to members at least twenty days prior to the effective date of a Bank's capital plan.

(b) In addition to Proxy Statement Disclosure, the following information shall be provided to members:

(1) The Bank shall disclose financial information as follows:

(i) Audited balance sheets as of the end of the two most recent fiscal years, statements of income and cash flows for each of the three fiscal years preceding the date of the most recent audited balance sheet being presented, and interim balance sheets and statements of income and cash flows as of and for appropriate interim dates that are in scope, form and content consistent with the requirements of the SEC's Regulations S-X and S-K (17 CFR parts 210 and 229);

(ii) Quarterly pro forma balance sheets and income statements covering two years from the "as of" date (next-to-latest quarter or latest quarter-end prior to submission of the capital plan) or, at a minimum, six quarters from the expected date of conversion to the new capital stock, whichever time period is greater, in detail sufficient to illustrate changes in the Bank's capital structure,

dividends, product volumes, investment volumes, and new business lines, and risk profile;

(iii) Pro forma risk-based capital requirement for the "as of" date and for the quarterly periods reflected pursuant to § 933.5(b)(1)(ii), if not already included in the pro forma balance sheet;

(iv) Disclosure of the assumptions underlying the pro forma financial information required by paragraphs (b)(1)(ii) and (b)(1)(iii) of this section, and the basis for these assumptions; and

(v) Any of the financial information required by § 933.5(b)(1) may be incorporated by reference, provided the information being incorporated is contained in an annual or quarterly Bank or Bank System report, or in information filed with the Finance Board along with the Bank's capital plan, and the disclosure identifies the information being incorporated by reference.

(2) Any amendments anticipated to be made to the Bank's by-laws, policies or other governance documents as a result of the implementation of the capital plan should be fully described.

(3) The Bank should state the name, address and telephone number where members may direct written or oral requests for a copy of the capital plan and any other instrument or document that defines the rights of the member/stockholders. This information shall be provided to the members without charge to them.

(4) The Bank shall provide a brief statement as to the anticipated accounting treatment and the federal income tax consequences of the transaction.

(c) Nothing in this section shall create or be deemed to create any rights in any third party.

Dated: August 1, 2001.

By the Board of Directors of the Federal Housing Finance Board.

J. Timothy O'Neill,

Chairman.

[FR Doc. 01-19852 Filed 8-7-01; 8:45 am]

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FEDERAL HOUSING FINANCE BOARD

12 CFR Parts 930 and 932

[No. 2001-16]

RIN 3069-AB11

Unsecured Credit Limits for Federal Home Loan Banks

AGENCY: Federal Housing Finance Board.

ACTION: Proposed rule.

SUMMARY: The Federal Housing Finance Board (Finance Board) is proposing to amend the unsecured credit provision of its rules, which was adopted as part of its capital rule on December 20, 2000 and governs the amount of unsecured credit that a Federal Home Loan Bank (FHLBank) can extend to a particular counterparty. The limits adopted in December were generally stricter than the limits under which the FHLBanks operated with the Finance Board's Financial Management Policy (FMP). The proposed amendments would set the amount of unsecured credit that an FHLBank can extend to a government-sponsored enterprise (GSE) at the level allowed under the FMP, adjust the limits for sales of overnight federal funds and the limits for unsecured credit that can be extended to groups of affiliated counterparties. They also would clarify how an FHLBank should calculate its credit exposures from on- and off-balance sheet items and derivative contracts and make other technical or clarifying changes to the unsecured credit provision. On March 7, 2001, the Finance Board published for comment in the **Federal Register** some of these proposed changes. Based in part on the comments received on that proposal, the Finance Board believes that broader changes to the rule than initially envisioned may be appropriate and is thereby proposing new amendments to the rule.

DATES: The Finance Board will consider written comments on the proposed rulemaking that are received on or before September 7, 2001.

ADDRESSES: Send comments to: Elaine L. Baker, Secretary to the Board, by electronic mail at bakere@fhfb.gov, or by regular mail at the Federal Housing Finance Board, 1777 F Street, NW., Washington, DC 20006. Comments will be available for inspection at this address.

FOR FURTHER INFORMATION CONTACT: James L. Bothwell, Managing Director, (202) 408-2821; Scott L. Smith, Acting Director, (202) 408-2991; or Julie Paller, Senior Financial Analyst, (202) 408-2842, Office of Policy, Research and Analysis; or Thomas E. Joseph, Senior Attorney-Advisor, (202) 408-2512, Office of General Counsel, Federal Housing Finance Board, 1777 F Street, NW., Washington, DC 20006.

SUPPLEMENTARY INFORMATION:

I. Introduction

On December 20, 2000, in accordance with the Gramm-Leach-Bliley Act, Pub. L. No. 106-102, 133 Stat. 1338 (November 12, 1999) (GLB Act), the

Finance Board adopted a final rule to implement the new capital structure that the GLB Act established for the FHLBanks. 66 FR 8262 (January 30, 2001). As part of the final capital rule, the Finance Board adopted new limits on the permitted amounts of an FHLBank's unsecured credit exposures to a single counterparty or a group of affiliated counterparties. *Id.* at 8318-19. See also 12 CFR 932.9. These new limits represent a revision and codification of the unsecured credit guidelines of Section VI of the FMP, Finance Board Res. No. 96-45 (July 3, 1996), as amended by Finance Board Res. No. 96-90 (December 6, 1996), Finance Board Res. No. 97-05 (January 14, 1997), and Finance Board Res. No. 97-86 (December 17, 1997), which will remain in effect until the earlier of October 1, 2001 or when the new limits currently being proposed are adopted as a final rule and take effect. See Finance Board Res. No. 2001-11 (June 5, 2001).

On March 7, 2001, the Finance Board published a proposed rule requesting comment on potential amendments to certain sections of the unsecured credit requirements. Specifically, the Finance Board requested comment on adjusting the limit on a Bank's unsecured extensions of credit to a GSE, including supporting analysis concerning the appropriate level for the new limit; and on excluding from the unsecured credit limits sales of federal funds with a maturity of one day or less, or federal funds sold under a continuing contract. These changes were proposed after FHLBanks indicated that, given the magnitude of the reduction in the allowable credit exposure to a GSE under § 932.9, they would experience difficulty in developing new investment strategies to conform to the new limits.

In conjunction with the Finance Board's approval of the proposed rule, the Finance Board also adopted a resolution waiving FHLBank compliance with the unsecured credit limits of § 932.9 and, because they are related to the unsecured credit limits, the liquidity requirements of § 932.8 of the Finance Board's rules, until July 2, 2001. See Finance Board Res. No. 2001-04 (February 28, 2001). The resolution also stipulated that the unsecured credit guidelines of Section VI of the FMP would remain in effect until the new effective date for §§ 932.8 and 932.9 of July 2, 2001. On June 5, 2001, the Finance Board adopted another resolution further delaying the implementation of §§ 932.8 and 932.9 until the earlier of October 1, 2001 or the completion of the current rulemaking process amending § 932.9, again subject to the FHLBanks'

continuing compliance with Section VI of the FMP.¹ See Finance Board Res. No. 2001-11 (June 5, 2001). This further delay was intended to provide additional time for consideration of the issues that were raised in the comments on the proposed rule, as well as to consider other possible amendments to the unsecured credit limits.

The Finance Board is now proposing amendments to the unsecured credit limits that address issues beyond those that were discussed in the proposed rule. Many of these issues were identified as a result of comments received on the proposed rule. Because the amendments now being proposed are more far-reaching, albeit rather technical in nature, than those previously proposed, the Finance Board believes it appropriate to solicit comments on them. Thus, the Finance Board is re-proposing amendments to its rule concerning unsecured credit limits for a 30-day comment period.

II. Discussion of the Comments Received

The Finance Board received nine comment letters on its proposal to amend the unsecured credit limits set forth in § 932.9 of its regulations. Eight of the comments were from FHLBanks, and the ninth was from the Council of Federal Home Loan Banks (Council). In addition to commenting on the proposed changes to the GSE credit limits, the letters also responded to the Finance Board's request for comments on excluding sales of federal funds with a maturity of one day or less or subject to a continuing contract² (together, "overnight federal funds") from the unsecured credit limits, as well as raising issues that had not been addressed by the proposal. The Finance Board carefully considered all of the comments received in drafting its new proposal, and discusses the most important comments below.

Credit Limits for GSEs. In its proposed rule, the Finance Board indicated that it intended to raise the unsecured credit limits applicable to GSEs. Eight of the nine commenters supported raising the limits on unsecured extensions of credit

to GSEs, and most, though not all of these commenters, indicated a specific limit that should be adopted. Five of the commenters urged the Finance Board to raise the limit to 100 percent of the lesser of the GSE's or an FHLBank's total capital, which is the equivalent of the current limit in the FMP.³ One commenter contended that a limit equal to 50 percent of an FHLBank's total capital would be sufficient. Another commenter recommended that a provision be added to make a GSE subject to the same unsecured credit limits that would apply to a non-GSE counterparty if the GSE's long-term debt were downgraded to less than the highest investment grade by any Nationally Recognized Statistical Rating Organization (NRSRO). These commenters noted that GSEs were highly-rated by NRSROs and viewed as better credit risks by the markets than even the highest rated non-GSE counterparties. They also argued that extensions of unsecured credit to GSEs provided a more liquid investment than most other investments available to the FHLBanks.

The Finance Board generally agrees with these commenters' observations and, as discussed more fully in the next section, is proposing to change the limits on unsecured extensions of credit to a GSE to the lesser of the FHLBank's total capital or the GSE's total capital. However, because the Finance Board's support for the proposed higher GSE limit is based in large part on the fact that GSEs have historically been viewed in debt markets more favorably than even the highest-rated corporate debt issuers, the Finance Board is also proposing to adopt the commenter's suggestion that the preferential unsecured credit limit for GSEs automatically ceases to apply if any NRSRO rates a GSE's senior unsecured obligations, or downgrades such obligations to a rating, less than the highest investment grade or if any NRSRO places a GSE on a credit watch for a potential downgrade. This provision would help ensure that the preferential unsecured credit limit would not be applied to any GSE undergoing obvious financial difficulties.

¹ The unsecured credit guidelines contained in § 932.9 of the Finance Board's rules are intended to replace Section VI of the FMP upon becoming effective, and delaying the implementation of § 932.9 requires that the FMP guidelines remain in place.

² Sales of federal funds subject to a continuing contract are overnight federal funds loans that are automatically renewed each day unless terminated by either the lender or the borrower. See Marvin Goodfriend and William Whelpley, *Federal Funds in Instruments of the Money Market* 10 (Federal Reserve Bank of Richmond 1998) (available at www.rich.frb.org/pubs/instruments).

³ Under Section VI of the FMP, unsecured extension of credit to a GSE may not exceed an FHL Bank's capital. Because the total capital of the Federal National Mortgage Association (FannieMae) and the Federal Home Loan Mortgage Corporation (Freddie Mac), the two major GSEs to which the FHLBanks extend unsecured credit, is larger than that of any single FHLBank, the limit proposed by commenters on unsecured credit to GSEs as applied to these two entities, and thus, as applied to almost all of the FHLBanks' lending to GSEs, would equal an FHLBank's total capital.

A commenter also suggested that the Finance Board make explicit that the unsecured credit limits applied to GSEs by § 932.9 also applied to unsecured extensions of credit from one FHLBank to another. The FMP currently excludes unsecured extensions of credit from one FHLBank to another from its credit limits. This exclusion was adopted in recognition of a long-standing business practice of inter-FHLBank lending. In adopting current § 932.9 of its regulations, the Finance Board did not incorporate the FMP's exclusion for inter-FHLBank extensions of unsecured credit, but it also did not explicitly address whether that exclusion was being removed. However, the Finance Board believes that inter-FHLBank lending does not raise any safety and soundness concerns and that the practice can be supervised without establishing specific limits. Thus, the Finance Board does not find a strong reason to disrupt a long-standing FHLBank practice, and is proposing to incorporate the FMP's exclusion for inter-FHLBank unsecured extensions of credit into the rule.

One commenter did not comment directly on the GSE limits but instead urged the Finance Board to adopt a different approach to setting the unsecured credit limits. Specifically, the commenter recommended that the limits be based on the lesser of some percentage of the FHLBank's capital or the counterparty's assets, and include an FHLBank System-wide limit on exposures at each credit rating level stated as a percentage of the counterparty's assets. Further, the commenter believed that each FHLBank should be allocated a *pro rata* share of this System-wide limit, and should be allowed to trade unused portions of that share with the other FHLBanks, subject to an overall limit on an FHLBank's unsecured credit exposure based upon a percentage of the FHLBank's capital.

The Finance Board believes that the approach suggested by this commenter would be very complex to implement and monitor. Furthermore, the general approach underlying the current and proposed versions of § 932.9 addresses the Finance Board's concerns with the potential concentration of unsecured credit with a limited number of counterparties, see 66 FR at 8302, but remains relatively straightforward to implement. Therefore, the Finance Board is not convinced that it need amend its basic approach to calculating the unsecured credit limits.

Overnight Federal Funds Transactions. In the **SUPPLEMENTARY INFORMATION** section of the proposed rule, the Finance Board also requested

comment as to whether it should exclude sales of overnight federal funds from the unsecured credit limit, as do other federal banking regulators. 66 FR at 13689. Seven commenters urged the Finance Board to exclude sales of overnight federal funds. Of these commenters, one also suggested that in the alternative, the Finance Board could adopt more lenient limits for these transactions. These commenters generally believed that excluding overnight federal funds transactions from the unsecured credit limits added relatively little risk to the FHLBank System and allowed the FHLBanks to undertake larger transactions with a group of known, highly-creditworthy counterparties. Another commenter urged the Finance Board to exclude only overnight federal funds transactions with GSEs. The final commenter did not support excluding specific types of transactions from the unsecured credit limits, indicating that the primary means for prudent risk diversification was the adoption of appropriate counterparty and concentration limits for each FHLBank and for the FHLBank System as a whole.

The Finance Board carefully considered these comments. The FHLBanks' sales of overnight federal funds, however, currently are included in the amount of unsecured credit that is subject to the FMP limits. In adopting the unsecured credit limits set forth in § 932.9, the Finance Board intended to implement stronger safeguards against undue concentrations of unsecured credit in individual or affiliated counterparties. Exempting all overnight federal funds transactions from these new unsecured credit limits would represent a significant loosening of current practices and would be inconsistent with the goal of implementing more rigorous limits.

The Finance Board has also considered the fact that other federal bank regulators exclude overnight federal funds transactions from their credit limits. See 12 CFR part 32 (Office of the Comptroller of the Currency (OCC)) and 12 CFR 560.93 (Office of Thrift Supervision (OTS)). However, the Finance Board also recognizes that commercial depository institutions and the FHLBanks have different incentives to lend in the federal funds markets. The FHLBanks can benefit from the funding advantage afforded by their GSE-status to borrow in the consolidated obligation (CO) market and then profitably lend those funds in the federal funds market. Commercial depository institutions, on the other hand, do not enjoy the same funding advantage as GSEs and generally lend

excess reserves that are on-hand in order to earn interest on such reserves. Because of the GSE funding advantage, adopting the same exclusion for overnight federal funds transactions as applies to commercial depository institutions would provide the FHLBanks with an incentive, not available to commercial institutions, to borrow in the CO market and expand their lending in the federal funds market. This type of arbitrage activity could create safety and soundness concerns if significant concentrations of unsecured credit were created because of unchecked, short-term lending to a limited number of counterparties.

The Finance Board, therefore, is not proposing to exclude sales of overnight federal funds from the unsecured credit limits, but is proposing more lenient limits for these transactions. The Finance Board believes that the proposed limits, which are described in more detail below, will provide the FHLBanks sufficient leeway to prudently invest funds to meet both their liquidity needs and to counter cyclical fluctuations in their business but still limit incentives to create undue concentrations of credit in a few counterparties.

Treatment of Affiliated Counterparties. The Finance Board did not propose amending, nor did it solicit comments on, the aggregate unsecured credit limits imposed on groups of affiliated counterparties by § 932.9(b) of its rules.⁴ Nevertheless, three commenters objected to this provision. In general, the commenters believed that the unsecured credit limits on affiliated counterparties severely restricted the FHLBanks' lending to large, creditworthy financial groups. They also contended that affiliated institutions that were separately chartered, capitalized and regulated should be treated as separate counterparties subject only to individual unsecured credit limits. Two of the commenters argued that it was particularly appropriate to treat regulated financial institutions as separate counterparties because the rules governing these entities mitigate the risks of cross-defaults. One commenter stated that the

⁴ Under § 932.9(b), the aggregate amount of unsecured credit that an FHL Bank may extend to a group of affiliated counterparties can not exceed the product of the maximum capital exposure limit applicable to the counterparty with the highest NRSRO credit rating multiplied by the lesser of the sum of total capital of all the affiliated counterparties or the total capital of the FHL Bank. See 12 CFR 932.9(b). In addition, an FHLBank's extensions of unsecured credit to each counterparty within a group of affiliated counterparties can not exceed the unsecured credit limit applicable to a particular counterparty.

OCC applied fairly restrictive tests to determine when a commercial bank must deem affiliated institutions to be a single institution for the purpose of applying the combined general limit on credit, with the result that aggregation was only infrequently required, see 12 CFR 32.5(a), and that the Finance Board should adopt a similar approach. This commenter also stated that special, bankruptcy-remote subsidiaries should not be considered affiliates for the purposes of applying the unsecured credit limitations.

The Finance Board has considered these comments but continues to believe that conservative, aggregate limits on the unsecured extensions of credit to affiliated counterparties are needed to prevent undue concentrations of credit in a limited number of counterparties at both the FHLBank level and the FHLBank System level. See 66 FR at 8302. Concentrations of credit in affiliated counterparties raise safety and soundness concerns because the financial difficulties or default of one party significantly raises the potential that affiliated entities will experience a deteriorating credit situation or default. These spillover effects would raise the potential for loss at an FHLBank if it had a significant unsecured credit exposure to a group of affiliated entities of which one or more were experiencing severe financial difficulties.

Moreover, other federal banking regulators recognize the safety and soundness problems raised by excessive concentrations of credit in affiliated entities and limit extensions of credit to groups of affiliated counterparties. The OCC's rules restrict a commercial bank's aggregate extensions of secured and unsecured credit to a corporate group to an amount not to exceed 50 percent of the bank's capital and surplus.⁵ See 12 CFR 32.5(d). The OTS, which has generally adopted the OCC's regulations on credit limits, albeit subject to certain specific changes, would also apply this limit. See 12 CFR 560.93(c). Applying credit exposure limits to groups of affiliated counterparties is also consistent with principles for sound management of credit risk as articulated by the Basel Committee on Banking Supervision (Basel Committee). See, Basel Committee, "Principles for the Management of Credit Risk" 10 (September 2000) ("An important element of credit risk management is the establishment of exposure limits on

single counterparties and groups of connected counterparties.")

Further, depository institutions are not necessarily immune from spill-over effects caused by the default of one of their affiliated institutions. For example, by law, depository institutions that are insured by the Federal Deposit Insurance Corporation (FDIC) may be held liable for the losses (or anticipated losses) to the FDIC caused by the default of affiliated, FDIC-insured institutions. See 12 U.S.C. 1815(e) and 12 CFR 308.165. More importantly, it would be inconsistent with the Finance Board's conservative approach to credit limits to assume that a default by one affiliated counterparty could not have a negative effect on other entities in that group. The Finance Board is persuaded, however, that the limit on an FHLBank's unsecured credit exposure to a group of affiliated counterparties adopted in § 932.9(b) may be too restrictive and, therefore, as discussed more fully below, is proposing a new limit equal to 30 percent of the FHLBank's total capital.

Application of Part 980. In the **SUPPLEMENTARY INFORMATION** section of the March proposing release, the Finance Board noted that:

[b]efore a [FHL]Bank may extend unsecured credit to any counterparty (or affiliated counterparties) to which a [FHL]Bank could not previously lend because the credit rating restrictions or maturity limitations in the FMP, the [FHL]Bank must obtain the Finance Board's approval for the lending activity as a new business activity pursuant to 12 CFR part 980.

66 FR at 13688. Five commenters objected to this application of the Finance Board's part 980 regulations. In general, the commenters believed that other Finance Board regulations, including the restrictions in § 932.9, adequately addressed the risks created by the FHLBanks' unsecured lending and that expansion of unsecured lending activities did not involve risks not previously undertaken or managed by the FHLBanks, as required by the part 980 regulations. Some commenters also noted that it was unclear how the part 980 requirements would be applied to unsecured lending activities.

The purpose of the part 980 regulations is to provide the Finance Board with prior notice that an FHLBank is undertaking an activity that among other things involves a risk not previously and regularly managed by the FHLBank so that the Finance Board may disapprove, examine, or restrict such activity as necessary on a case-by-case basis. See 65 FR 44414, 44420 (July 18, 2000) (discussing part 980 regulations). Prior notice, therefore,

provides the Finance Board with a needed opportunity to verify that the new activity will be executed in a safe and sound manner, regardless of whether the activity in question is authorized or otherwise addressed by other provisions in the Finance Board's regulations. *Id.*

In this respect, as investment and lending restrictions imposed by the FMP are lifted, the FHLBanks will be able to take on exposures to different types of counterparties and for much longer maturities than was allowed under the FMP. Such authority could allow an FHLBank to develop new investment strategies that would alter its risk profile and involve new risks for the FHLBank. The Finance Board continues to believe, therefore, that approval under the part 980 regulations is proper before the FHLBanks undertake significant lending or investing activities that were not permitted under the FMP.

Given the comments received on this matter, however, the Finance Board wishes to clarify when a notice filing under part 980 may be required for new unsecured lending activities. The FHLBanks will not be required to provide notice under part 980 each time they intend to lend to a new counterparty, or to purchase a new class of debt instrument or to take on a credit exposure that would have been prohibited under the FMP, if such activity involves only marginal changes in the FHLBank's investment portfolio.⁶ However, should an FHLBank adopt strategies that would require it to take on, or should the FHLBank begin to take on, more significant unsecured credit exposures to classes of counterparties to which lending was previously prohibited by the FMP or for maturities not allowed under the FMP, the Finance Board would expect the FHLBank to file a new business activity notice covering the change to the FHLBank's lending or investing strategy.

Other Issues. Five commenters requested that the Finance Board add a provision to § 932.9 to grandfather any investments that were made before the effective date of § 932.9 and conformed with the controlling FMP provisions whether or not these positions conformed to § 932.9. In general, a regulation does not have retroactive effect, and as the Finance Board previously stated, there is nothing in § 932.9 to suggest that an FHLBank must unwind positions that do not conform to the new limits provided that the credit

⁵ This requirement is distinct from the OCC regulation cited by the commenter, 12 CFR 32.5(a), that governs when a commercial bank must deem affiliated persons to be a single person for the purposes of applying the combined general limit.

⁶ Such activity would have to be authorized by and comply with applicable Finance Board regulations.

was extended in accordance with the FMP before the effective date of the new rule. 66 FR at 13688. The Finance Board does not believe that additional changes need to be made to the rule to make this point any more explicit. Furthermore, the FHLBanks should have sufficient time to adjust overnight extensions of unsecured credit, including sales of federal funds subject to a continuing contract, so as to be in compliance with the new limits on these transactions on the effective date of the rule.

Two commenters asked the Finance Board to delay the effective date of § 932.9 until after the capital plans have been approved and implemented. The safety and soundness concerns, however, raised by undue concentrations of credit in a limited number of counterparties are not related to the implementation of the FHLBanks' new capital structures required by the GLB Act. While the Finance Board has been willing to delay the effective date of § 932.9 to assure that the rule can be implemented with the least disruption possible, it still believes that its concerns with concentrations of credit should be addressed in as timely a fashion as possible. Therefore, it would not be prudent to delay the effective date of § 932.9 until the FHLBanks' capital plans are implemented.

One commenter noted that sections of the FMP, other than the section controlling unsecured extensions of credit, impose counterparty and maturity limitations on the FHLBanks' lending activities, and the commenter specifically requested that the Finance Board rescind certain investment restrictions set forth in Section II.B of the FMP. In this respect, the Finance Board's investment regulation states that investments authorized thereunder are subject to among other things, the FMP. See 12 CFR 956.2. In adopting the investment regulation, the Finance Board addressed the continued applicability of the FMP's investment restrictions. See 65 FR 43969, 43980 (July 17, 2000). The Finance Board sees no reason to reconsider this issue as part of this rulemaking.

III. Proposed Changes to the Rule

Change in GSE Limit. As already noted, the Finance Board agrees with commenters on the amendments proposed in March 2001 that the reduction of the unsecured limits for GSEs that would be implemented under § 932.9 could be disruptive to the FHLBanks investment strategies and programs, and that, historically, GSEs have been viewed more favorably by debt markets than even the highest-rated corporate debt issuers. In addition, the Finance Board believes that the limit

contained in the FMP does not raise any safety and soundness concerns. Thus, the Finance Board is now proposing a limit on unsecured credit exposure to GSEs of 100 percent of the lesser of FHLBank capital or the counterparty's capital.

In addition, proposed § 932.9(c)(2) would treat GSEs like other private counterparties in the event any NRSRO assigns a credit rating to, or downgrades the credit rating of, any long-term, senior unsecured debt obligation issued by a GSE to below the highest investment grade, or places the GSE on a credit watch for a potential downgrade. In this case, the FHLBank would be required to calculate the maximum amount of its unsecured extensions of credit to that GSE in accordance with paragraph (a)(1) of the proposed rule.

Further, proposed § 932.9(c)(3) would incorporate the FMP exclusion for inter-FHLBank credit exposure, as discussed above. Under this proposal, extensions of credit to another FHLBank would still be subject to the reporting requirements of § 932.9, which have been redesignated as paragraph (e) in the proposed rule.

Overnight Fed Funds. In the proposed rule, the Finance Board requested comments on whether it should exclude from the unsecured credit limits, the sale of federal funds with a maturity of one day or less, or federal funds sold under a continuing contract, given that other commercial bank regulators have adopted such an exclusion from the limits they impose on regulated institutions. As already discussed, the Finance Board sees merit in commenters' arguments supporting such an exclusion, but believes that because the FHLBanks could potentially have very large positions in overnight federal funds transactions, not retaining some limit on exposure from these federal funds transactions could raise safety and soundness concerns. Thus, the Finance Board is proposing to retain a limit on sales of federal funds with a maturity of one day or less and sales of federal funds subject to a continuing contract, but increase the limit applicable to a counterparty on such sales. Specifically, the proposal would require an FHLBank always to meet two limits. The first limit, the term limit set forth in proposed § 932.9(a)(1), would apply to all unsecured extensions of credit except overnight federal funds transactions, and the second limit, the overall limit set forth in proposed § 932.9(a)(2), would be twice the term limit, and would apply to all unsecured extensions of credit including overnight federal funds transactions.

Under proposed § 932.9(a)(1), an FHLBank would not include sales of federal funds with a maturity of one day or less and sales of federal funds subject to a continuing contract in its calculation of unsecured extensions of credit to a specific counterparty. Such overnight federal funds transactions would therefore not be subject to the term limit on unsecured extensions of credit that would be imposed under this proposed provision. However, under proposed § 932.9(a)(2), an FHLBank would add into its calculation of total extensions of unsecured credit all sales of federal funds with a maturity of one day or less and sales of federal funds subject to a continuing contract with the counterparty. The resulting total amount of unsecured credit including these overnight sales of federal funds could not exceed an overall limit equal to twice the term limit.

For example, if a counterparty's applicable credit rating was determined to be the highest investment grade category, the term limit that would apply under proposed § 932.9(a)(1) would equal 15 percent of the lesser of the FHLBank's total capital, or the counterparty's Tier 1 capital, or if Tier 1 capital is not available, total capital (as defined by the counterparty's principal regulator) or some similar comparable measure identified by the FHLBank. The overall limit under proposed § 932.9(a)(2) would apply when sales of overnight federal funds are added into the total extensions of unsecured credit to the counterparty. The overall limit would equal 30 percent of the lesser of the FHLBank's total capital or the counterparty's applicable capital measurement but, because the term limit would also apply, an FHLBank's extensions of unsecured extensions of credit, other than overnight federal funds transactions, could not exceed 15 percent of the FHLBank's total capital or the counterparty's applicable capital measurement.

In addition, the Finance Board is proposing to define "sales of federal funds subject to a continuing contract" as an overnight federal funds loan that is automatically renewed each day unless terminated by either the lender or the borrower. This definition is consistent with the generally understood meaning of the term. See Goodfriend and Whelpley, n.2, *supra*.

Maximum capital exposure limits. The Finance Board is proposing to change the maximum capital exposure limits listed in Table 4. The Finance Board is also proposing to simplify the FHLBanks' monitoring of a

counterparty's credit rating by changing the rule to require that the applicable maximum exposure limit in Table 4 be determined based on a counterparty's long-term credit rating, and that a short-term credit rating be used only if the counterparty has a short-term, but no long-term, rating from an NRSRO. These changes are discussed in more detail below.

The general approach adopted in § 932.9, however, of imposing more restrictive maximum capital exposure limits on lower-rated, and therefore potentially riskier, counterparties is not altered by the proposed rule amendments. This general approach is consistent with principles for sound management of credit risk articulated by the Basel Committee on Banking Supervision (Basel Committee), which has stated that:

[a]n important element of credit risk management is the establishment of exposure limits on single counterparties and groups of connected counterparties. Such limits are frequently based in part on internal risk rating assigned to the borrower with counterparties assigned better risk ratings having potentially higher exposure limits.

Basel Committee, "Principles for the Management of Credit Risk" 10–11 (September 2000). It is also consistent with the approach adopted in § 932.4 of the Finance Board's rules with regard to the credit risk percentage requirements, which are used to calculate the risk-based capital charges for credit risk and which vary with the potential risk of an asset, as evidenced by the asset's applicable NRSRO long-term credit rating.

As proposed, the applicable maximum capital exposure limit for a counterparty rated at the highest investment grade by an NRSRO would remain 15 percent. This level is broadly consistent with federal lending limits pertaining to commercial banks as set forth by statute and regulation, although the fifteen-percent limit for commercial banks remains the same regardless of the credit rating of the borrower. See 12 U.S.C. 84, and 12 CFR part 32. The proposed maximum capital exposure limits corresponding to credit ratings below the highest investment grade, however, are calibrated to the 15 percent maximum capital exposure limit based upon the ratio of the average credit risk percentage requirement (over all maturity bucket groupings) for the highest investment grade to the average credit risk percentage requirement for each investment grade.⁷ The logic of

this approach is that as credit risk, as captured in the credit risk percentage requirements, increases, the unsecured credit limit proportionately decreases. Further, because the credit risk percentage requirements were derived from actual corporate bond default data, the relative differences among the proposed maximum capital exposure limits more closely reflect historic credit loss experiences than do the differences among the current maximum capital exposure limits set forth in § 932.9. See 66 FR 8287–88 (explaining the derivation of the credit risk percentage requirements in Table 1.3).

To perform the required calculation, the Finance Board first averaged the credit risk percentage requirements for each credit rating category across all maturity buckets provided in Table 1.3. The average credit risk percentage requirement corresponding to the highest investment grade was then divided by the average credit risk percentage requirement corresponding to each of the other investment grades. The result of this calculation for each investment grade, and for the highest below-investment grade rating category, was then multiplied by 15 percent—the maximum capital exposure limit corresponding to the highest investment grade—and the product was rounded to the nearest whole percentage point. The result of the calculation, as rounded, for each investment grade equals the proposed maximum capital exposure limit with the result of the calculation for the highest below-investment grade rating category being used to set the proposed maximum capital exposure limit for the category, "Below Investment Grade or Other," in Table 4.

Section 932.9(a)(3) of the proposed rule also would require an FHLBank to determine the maximum capital exposure limit applicable to a counterparty based primarily on the counterparty's long-term credit rating. Under this proposed change, a short-term credit rating would be used only in the rare circumstance that an NRSRO has provided a short-term credit rating for a counterparty but has not provided a long-term rating for that counterparty. Further, the Finance Board is proposing that where a short-term credit rating is used, the highest short-term investment grade rating would correspond to the maximum capital exposure limit assigned to the third highest long-term investment grade rating in proposed Table 4 (*i.e.*, nine percent), and the second and third highest short-term investment grade ratings would correspond to the maximum capital exposure limit assigned to the fourth highest long-term investment grade

rating in proposed Table 4 (*i.e.*, 3 percent).

The proposed approach for determining the applicable maximum capital exposure limit is the same as the approach already adopted in § 932.4 of the Finance Board's capital rule for determining the credit risk percentage requirement applicable to a particular asset. See 12 CFR 932.4(e)(2)(ii)(C). Reliance on long-term NRSRO credit ratings as an approximation of credit risk is also consistent with the approach for assigning risk weightings for assets suggested by the Basel Committee under its standardized approach in the proposed New Basel Capital Accord. See Basel Committee, "Overview of the New Basel Capital Accord" 13–14 (January 2001) and Basel Committee, "A New Capital Adequacy Framework" 26–36 (June 1999).

Moreover, the Finance Board believes that the proposed use of long-term credit ratings to determine the maximum capital exposure limit would more accurately reflect the relative default risks among counterparties. Based on Moody's default data from 1970 to 2000, counterparties that are rated in the highest short-term investment grade or third highest long-term investment grade categories have a significantly higher 30-day maximum default rate than those rated in the highest or second highest investment grade long-term credit rating.⁸ Similarly,

⁸ Generally, NRSROs use three short-term credit ratings that are considered investment grade. Counterparties with different long-term ratings may be grouped in the same short-term credit rating category, however. For example, in rating short-term commercial paper, Moody's assigns the highest category, however. For example, in rating short-term commercial paper, Moody's assigns the highest short-term investment grade credit rating to issuers that would have long-term credit ratings ranging from the highest investment grade to the third highest investment grade and assigns the second highest short-term investment grade rating to issuers that would have long-term credit ratings of either the third highest investment grade or the fourth highest investment grade. See "Commercial Paper Defaults and Rating Transitions," 1972–2000, Moody's Investors Service (October 2000); "Moody's Credit Opinions: Financial Institutions," Moody's Investors Service (December 1999). The lowest short-term investment grade rating is assigned solely to issuers that also have the fourth highest long-term investment grade credit rating. *Id.* A comparison of U.S. financial institutions' short-term ratings by Moody's also shows that the highest short-term investment grade credit rating is more commonly associated with the third highest long-term investment grade credit rating than with the highest or second highest long-term investment grade credit ratings. See "Moody's Credit Opinions: Financial Institutions," Moody's Investors Service (March 2000). The maximum 30-day default rate for commercial paper rated at the highest short-term investment grade (*i.e.*, P-1), based on Moody's data for the period 1972–2000, is 0.08 percent. However, the maximum 30 day default rate for the third highest long-term rating (*i.e.*, A) is 0.24%, but is

⁷ The credit risk percentage requirements are set forth in § 932.4, Table 1.3 of Part 932 of the Finance Board rules. 12 CFR 932.4.

counterparties rated in the second highest short-term investment grade and the fourth highest long-term investment grade category have the same 30-day maximum default rate of 0.32 percent. These differences indicate that use of the short-term ratings alone to set the unsecured credit limitations may not reflect the true rates of default among counterparties, and that despite having the same short-term credit ratings, counterparties with a lower long-term credit rating may display a significantly higher maximum 30-day default rate. Thus, use of long-term ratings as a basis for determining the applicable maximum capital exposure limit would assure that a more restrictive unsecured credit limit is imposed on counterparties with the higher default rate, even when applied to short-term credit exposures.

Relying primarily on long-term credit ratings to determine the applicable maximum capital exposure limit also would simplify the FHLBanks' monitoring of counterparties credit ratings. Currently, § 932.9 requires that the maximum capital exposure limit corresponding to the higher of a counterparty's short-term or long-term credit rating be used to calculate the total unsecured credit limit for the counterparty, while the lower of the two ratings be used to calculate the limit applicable to any unsecured credit with a maturity corresponding to the ratings. See 12 CFR 932.9(a)(3)(iii). To implement the rule, the FHLBanks, therefore, would be required to track the long- and short-term credit ratings assigned to each counterparty by each NRSRO. The proposed rule change would allow the FHLBanks to monitor a counterparty's long-term credit ratings only, except in rare circumstances.

The proposed rule still would allow the use of short-term ratings to determine the maximum capital exposure limit when an NRSRO has not provided a long-term rating to a counterparty. For this purpose, however, the proposed rule, in effect, deems the highest short-term investment grade credit rating to be the equivalent of the third highest long-term investment grade credit rating and the second and third highest short-term investment grade ratings to be the equivalent of the fourth highest long-term investment grade rating.

This approach is consistent with the approach adopted in § 932.4 for determining the credit risk percentage requirement where an NRSRO has assigned a short-term rating to an asset

but not a long-term rating. See 12 CFR 932.4(e)(2)(ii)(C). See also 66 FR 8291–92 (discussing reason for adopting 12 CFR 932.4(e)(2)(ii)(C)). This treatment of the short-term investment grade credit ratings also reflects the fact that, as discussed above, a counterparty with the highest short term credit rating would be rated in at least the third highest long-term investment grade category, and a counterparty receiving the second or third highest short-term investment grade ratings would be rated in at least the fourth highest long-term investment grade category. See note 8, *supra*. Deeming a short-term rating to be equivalent to the lowest potential long-term investment grade credit rating that a counterparty could have is also consistent with the conservative approach proposed by the Finance Board for setting unsecured credit limits.

Affiliated counterparties. As already discussed, the Finance Board has considered comments received on this provision and has decided to propose an amendment to the affiliated counterparty limit. Under proposed § 932.9(b), the aggregate limit on the extension of unsecured credit to a group of affiliated counterparties would equal 30 percent of the FHLBank's total capital. In calculating the amounts of unsecured credit extended to a group of affiliated counterparties, the proposed rule would require an FHLBank to include the amounts of sales of overnight federal funds to those affiliated counterparties. The proposed rule also makes clear that unsecured credit limitations on individual counterparties continue to apply to each counterparty within a group of affiliated counterparties.

The proposed aggregate limit on extensions of credit to affiliated counterparties would provide the FHLBanks with more flexibility to extend somewhat larger amounts of unsecured credit to large financial groups than does the current aggregate limit in § 932.9. Given historic FHLBank lending patterns and the FHLBank's current counterparties that would benefit from this additional lending flexibility, the Finance Board does not believe that the proposed change in the aggregate limit, if adopted, would result in a build-up of unsecured credit exposures of questionable quality. Furthermore, the Finance Board believes that the proposed aggregate limit on lending to affiliated counterparties remains sufficiently restrictive, especially when coupled with the proposed individual counterparty limits, to keep unsecured credit exposure concentrations to

affiliated counterparties from raising safety and soundness concerns.

The Finance Board also is proposing to amend the definition of affiliated counterparty in § 930.1 to read as follows:

Affiliated counterparty means a counterparty of a Bank that controls, is controlled by or is under common control with another counterparty of the Bank. For the purposes of this definition only, direct or indirect ownership (including beneficial ownership) of more than 50 percent of the voting securities or voting interests of an entity constitutes control.

The proposed definition would generally raise the threshold for control from ownership (either direct or indirect) of 25 percent of the voting securities or voting interests of an entity to ownership (either direct or indirect) to 50 percent of the voting securities or voting interests of an entity. This change, however would not significantly alter the number or groupings of counterparties that would be covered by the proposed affiliated counterparty limitations because traditionally most groups of affiliated counterparties to which the FHLBanks have lent have consisted of groups of wholly-owned, or nearly wholly-owned, subsidiaries of a parent corporation. Furthermore, the proposed definition is more consistent with the meaning of corporate group, as that phrase is used in OCC's rules limiting extensions of credit, see 12 CFR 32.5(d), than is the current definition of affiliated counterparty in § 930.1 of the Finance Board rules. The Finance Board also believes that the proposed definition is more easily understood than the current definition.

Addition of Transition Provision for Downgrades. The proposed rule contains transition provisions for FHLBanks that have extended unsecured credit to counterparties that are downgraded or placed on credit watch. Proposed § 932.9(d) provides that in the event a lower maximum credit limit is imposed on a counterparty because an NRSRO has downgraded the credit rating applicable to a counterparty or has placed a counterparty on a credit watch for a potential downgrade, an FHLBank is not required to unwind or liquidate any transaction or position that was entered into prior to the date of the downgrade or the placement on credit watch so long as the transaction or position complied with the limits at the time it was entered. However, any new unsecured extensions of credit to the counterparty would have to comply with the new lower maximum exposure limit. A similar transition provision is

zero percent for the highest (i.e., AAA) or second highest (i.e., AA) long-term rating.

contained in the FMP. Because an FHLBank might have to accept less than the remaining balance on a debt if it were required to liquidate or unwind a position within a particular timeframe, especially if the counterparty in question were undergoing financial stress, the Finance Board believes that it is appropriate to maintain such a provision in the unsecured credit regulation.

In addition, the proposed rule makes clear that a renewal of an existing unsecured extension of credit, including any decision not to terminate a sale of federal funds subject to a continuing contract, would be considered a new extension of unsecured credit.

Addition of provision for calculating extensions of credit. Neither the final capital rule nor the proposed rule published on March 7, 2001 contained specific requirements for how to measure unsecured extensions of credit. Proposed § 932.9(f) would now specify how the FHLBanks would measure unsecured extensions of credit. Consistent with the requirements of the FMP, the proposed rule would require the amount of unsecured credit exposure arising from on-balance sheet transactions be equal to the sum of the book value of the item plus net payments due the Bank. For off-balance sheet and derivative transactions, the Finance Board is proposing that the measurement conform to the measurement under § 932.4 for the purpose of calculating the required credit risk-based capital charge. Thus, the proposed rule specifies that unsecured credit exposures arising from off-balance sheet and derivatives transactions be measured in accordance with §§ 932.4(f) and 932.4(g) or § 932.4(h) of the Finance Board's regulations, respectively.

Other technical changes. The reporting requirements now contained in § 932.9(c) of the Finance Board rules are found in paragraph (e) of the proposed rule, but have not been altered in substance. Similarly, the provisions concerning the FHLBanks' determination of a counterparty's applicable credit ratings have been redesignated as § 932.9(a)(4) in the proposed rule, and would be substantively altered only to remove the provision that required an FHLBank to use different maximum capital exposure limits for short-and long-term unsecured extensions of credit, because that provision would not conform to the proposed approach for determining these limits, as discussed above.

The Finance Board also is proposing to change the wording in § 932.9 so that derivative contracts are identified as

items distinct from on-or off-balance sheet items. The wording change is being proposed because of changes required by Statement of Financial Accounting Standards (SFAS) No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and would conform the wording of § 932.9 to changes made to other provisions of part 932 when the Finance Board adopted the final capital rule. See 66 FR at 8281 (discussing reference to derivative contracts in final capital rule). This proposed change would not affect the substance of how derivatives contracts would be treated under the proposed rule.

The Finance Board also is proposing to add new paragraph (g) to § 932.9 to make clear that obligations of, or guaranteed by, the United States would not be subject to any of the requirements of § 932.9 (including the reporting requirements that are contained in proposed § 932.9(e)). This exclusion is contained in the FMP limitations on unsecured credit but was not included in § 932.9 when the rule was adopted. The Finance Board, however, has stated that § 932.9 does not apply to obligations backed by the full faith and credit of the United States, see 66 FR at 13688, and the proposed change would merely codify this position.

IV. Regulatory Flexibility Act

The final rule would apply only to the FHLBanks, which do not come within the meaning of small entities as defined in the Regulatory Flexibility Act (RFA). See 5 U.S.C. 601(6). Therefore, in accordance with section 605(b) of the RFA, 5 U.S.C. 605(b), the Finance Board hereby certifies that this proposed rule, if promulgated as a final rule, will not have a significant economic effect on a substantial number of small entities.

V. Paperwork Reduction Act

The proposed rule does not contain any collections of information pursuant to the Paperwork Reduction Act of 1995. See 44 U.S.C. 3501 *et seq.* Therefore, the Finance Board has not submitted any information to the Office of Management and Budget for review.

Lists of Subjects in 12 CFR Parts 930 and 932

Capital, Credit, Federal home loan banks, Investments, Reporting and recordkeeping requirements.

Accordingly, the Federal Housing Finance Board proposes to amend title 12, chapter IX, Code of Federal Regulations as follows:

PART 930—DEFINITIONS APPLYING TO RISK MANAGEMENT AND CAPITAL REGULATIONS

1. The authority citation for part 930 continues to read as follows:

Authority: 12 U.S.C. 1422a(a)(3), 1422b(a), 1426, 1440, 1443, 1446.

2. In § 930.1 revise the definition of *Affiliated counterparty*, and add, in correct alphabetical order the definition for *Sales of federal funds subject to a continuing contract*, to read as follows:

§ 930.1 Definitions.

* * * * *

Affiliated counterparty means a counterparty of a Bank that controls, is controlled by or is under common control with another counterparty of the Bank. For the purposes of this definition only, direct or indirect ownership (including beneficial ownership) of more than 50 percent of the voting securities or voting interests of an entity constitutes control.

* * * * *

Sales of federal funds subject to a continuing contract means an overnight federal funds loan that is automatically renewed each day unless terminated by either the lender or the borrower.

* * * * *

PART 932—FEDERAL HOME LOAN BANK CAPITAL REQUIREMENTS

3. The authority citation for part 932 continues to read as follows:

Authority: 12 U.S.C. 1422a(a)(3), 1422b(a), 1426, 1440, 1443, 1446.

4. Revise § 932.9, to read as follows:

§ 932.9 Limits on unsecured extensions of credit to one counterparty or affiliated counterparties; reporting requirements for total extensions of credit to one counterparty or affiliated counterparties.

(a) *Unsecured extensions of credit to a single counterparty.* A Bank shall not extend unsecured credit to any single counterparty (other than a GSE) in an amount that would exceed the limits of this paragraph. A Bank shall not extend unsecured credit to a GSE in an amount that would exceed the limits set forth in paragraph (c) of this section.

(1) *Term limits.* All unsecured extensions of credit by a Bank to a single counterparty that arise from the Bank's on-and off-balance sheet and derivative transactions (but excluding the amount of sales of federal funds with a maturity of one day or less and sales of federal funds subject to a continuing contract) shall not exceed the product of the maximum capital exposure limit applicable to such counterparty, as determined in

accordance with paragraph (a)(3) and Table 4 of this part, multiplied by the lesser of:

- (i) The Bank's total capital; or
- (ii) The counterparty's Tier 1 capital, or if Tier 1 capital is not available, total capital (as defined by the counterparty's principal regulator) or some similar comparable measure identified by the Bank.

(2) *Overall limits including sales of overnight federal funds.* All unsecured extensions of credit by a Bank to a single counterparty that arise from the Bank's on-and off-balance sheet and derivative transactions, including the amounts of sales of federal funds with a maturity of one day or less and sales of federal funds subject to a continuing contract, shall not exceed twice the limit calculated pursuant to paragraph (a)(1) of this section.

(3) *Bank determination of applicable maximum capital exposure limits.* (i) Except as set forth in paragraph (a)(3)(ii) of this section, the applicable maximum capital exposure limits for specific counterparties are assigned to each counterparty based upon the long-term credit rating of the counterparty, as determined in accordance with paragraph (a)(4) of this section, and are provided in the following Table 4 of this part:

TABLE 4.—MAXIMUM LIMITS ON UNSECURED EXTENSIONS OF CREDIT TO A SINGLE COUNTERPARTY BY COUNTERPARTY LONG-TERM CREDIT RATING CATEGORY

| Long-term credit rating of counterparty category | Maximum capital exposure limit (in percent) |
|--|---|
| Highest Investment Grade | 15 |
| Second Highest Investment Grade | 14 |
| Third Highest Investment Grade | 9 |
| Fourth Highest Investment Grade | 3 |
| Below Investment Grade or Other | 1 |

(ii) If a counterparty does not have a long-term credit rating but has received a short-term credit rating from an NRSRO, the maximum capital exposure limit applicable to that counterparty shall be based upon the short-term credit rating, as determined in accordance with paragraph (a)(4) of this section, as follows:

(A) The highest short-term investment grade credit rating shall correspond to the maximum capital exposure limit provided in Table 4 of this part for the

third highest long-term investment grade rating;

(B) The second highest short-term investment grade rating shall correspond to the maximum capital exposure limit provided in Table 4 of this part for the fourth highest long-term investment grade rating; and

(C) The third highest short-term investment grade rating shall correspond to the maximum capital exposure limit provided in Table 4 of this part for the fourth highest long-term investment grade rating.

(4) *Bank determination of applicable credit ratings.* The following criteria shall be applied to determine a counterparty's credit rating:

(i) The counterparty's most recent credit rating from a given NRSRO shall be considered;

(ii) If only one NRSRO has rated the counterparty, that NRSRO's rating shall be used. If a counterparty has received credit ratings from more than one NRSRO, the lowest credit rating from among those NRSROs shall be used;

(iii) Where a credit rating has a modifier, the credit rating is deemed to be the credit rating without the modifier;

(iv) If a counterparty is placed on a credit watch for a potential downgrade by an NRSRO, the credit rating from that NRSRO at the next lower grade shall be used; and

(v) If a counterparty is not rated by an NRSRO, the Bank shall determine the applicable credit rating by using credit rating standards available from an NRSRO or other similar standards.

(b) *Unsecured extensions of credit to affiliated counterparties.* (1) *In general.* The total amount of unsecured extensions of credit by a Bank to a group of affiliated counterparties that arise from the Bank's on-and off-balance sheet and derivative transactions, including sales of federal funds with a maturity of one day or less and sales of federal funds subject to a continuing contract, shall not exceed thirty percent of the Bank's total capital.

(2) *Relation to individual limits.* The aggregate limits calculated under this paragraph shall apply in addition to the limits on extensions of unsecured credit to a single counterparty imposed by paragraph (a) of this section.

(c) *Special limits for GSEs.* (1) *In general.* Unsecured extensions of credit by a Bank to a GSE that arise from the Bank's on-and off-balance sheet and derivative transactions, including any sales of federal funds with a maturity of one day or less and sales of federal funds subject to a continuing contract, shall not exceed the lesser of:

- (i) The Bank's total capital; or

(ii) The GSE's total capital (as defined by the GSE's principal regulator) or some similar comparable measure identified by the Bank.

(2) *Limits applying to a GSE after a downgrade.* If any NRSRO assigns a credit rating to any senior unsecured obligation issued (or to be issued) by a GSE that is below the highest investment grade or downgrades, or places on a credit watch for a potential downgrade of, the credit rating on any senior unsecured obligation issued by a GSE to below the highest investment grade, the special limits on unsecured extensions of credit under paragraph (c)(1) of this section shall cease to apply, and instead, the Bank shall calculate the maximum amount of its unsecured extensions of credit to that GSE in accordance with paragraphs (a)(1) and (a)(2) of this section.

(3) *Extensions of unsecured credit to other Banks.* The limits of this section do not apply to unsecured credit extended by one Bank to another Bank.

(d) *Extensions of unsecured credit after downgrade or placement on credit watch.* If an NRSRO downgrades the credit rating applicable to any counterparty or places any counterparty on a credit watch for a potential downgrade, a Bank need not unwind or liquidate any existing transaction or position with that counterparty that complied with the limits of this section at the time it was entered. In such a case, however, a Bank may extend any additional unsecured credit to such a counterparty only in compliance with the limitations that are calculated using the lower maximum exposure limits. For the purposes of this section, the renewal of an existing unsecured extension of credit, including any decision not to terminate any sales of federal funds subject to a continuing contract, shall be considered an additional extension of unsecured credit that can be undertaken only in accordance with the lower limit.

(e) *Reporting requirements.* (1) *Total unsecured extensions of credit.* Each Bank shall report monthly to the Finance Board the amount of the Bank's total unsecured extensions of credit arising from on-and off-balance sheet and derivative transactions to any single counterparty or group of affiliated counterparties that exceeds 5 percent of:

- (i) The Bank's total capital; or
- (ii) The counterparty's, or affiliated counterparties' combined, Tier 1 capital, or if Tier 1 capital is not available, total capital (as defined by each counterparty's principal regulator) or some similar comparable measure identified by the Bank.

(2) *Total secured and unsecured extensions of credit.* Each Bank shall report monthly to the Finance Board the amount of the Bank's total secured and unsecured extensions of credit arising from on-and off-balance sheet and derivative transactions to any single counterparty or group of affiliated counterparties that exceeds 5 percent of the Bank's total assets.

(f) *Measurement of unsecured extensions of credit.* For purposes of this section, unsecured extensions of credit will be measured as follows:

(1) For on-balance sheet transactions, an amount equal to sum of the book value of the item plus net payments due the Bank;

(2) For off-balance sheet transactions, an amount equal to the credit equivalent amount of such item, calculated in accordance with § 932.4(f) of this part; and

(3) For derivative transactions, an amount equal to the sum of the current credit exposure and the potential future exposure for the derivative contract, where the current credit exposure and potential future credit exposure are calculated in accordance with §§ 932.4(g) or 932.4(h) of this part, as applicable.

(g) *Obligations of the United States.* Obligations of, or guaranteed by, the United States are not subject to the requirements of this section.

Dated: August 1, 2001.

By the Board of Directors of the Federal Housing Finance Board.

J. Timothy O'Neill,
Chairman.

[FR Doc. 01-19851 Filed 8-7-01; 8:45 am]

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DEPARTMENT OF VETERANS AFFAIRS

38 CFR Part 3

RIN 2900-AK64

Diseases Specific to Radiation-Exposed Veterans

AGENCY: Department of Veterans Affairs.

ACTION: Proposed rule.

SUMMARY: The Department of Veterans Affairs (VA) is proposing to amend its adjudication regulations concerning presumptive service connection for certain diseases for veterans who participated in radiation-risk activities during active service or while members of reserve components during active duty for training or inactive duty training. This proposed amendment would add cancers of the bone, brain,

colon, lung, and ovary to the list of diseases which may be presumptively service connected and amend the definition of the term "radiation-risk activity." The intended effect of this amendment is to ensure that veterans who may have been exposed to radiation during military service have the same burden of proof as civilians exposed to ionizing radiation who may be entitled to compensation for these cancers under comparable Federal statutes.

DATES: Comments must be received on or before October 9, 2001.

ADDRESSES: Mail or hand-deliver written comments to: Director, Office of Regulations Management (02D), Department of Veterans Affairs, 810 Vermont Ave., NW, Room 1154, Washington, DC 20420; or fax comments to (202) 273-9289; or e-mail comments to OGCRegulations@mail.va.gov. Comments should indicate that they are submitted in response to "RIN 2900-AK64." All comments received will be available for public inspection in the Office of Regulations Management, Room 1158, between the hours of 8 a.m. and 4:30 p.m., Monday through Friday (except holidays).

FOR FURTHER INFORMATION CONTACT: Bill Russo, Regulations Staff, Compensation and Pension Service, Veterans Benefits Administration, Department of Veterans Affairs, 810 Vermont Avenue, NW, Washington, DC 20420, telephone (202) 273-7210.

SUPPLEMENTARY INFORMATION: Under the provisions of the Radiation-Exposed Veterans Compensation Act of 1988, Pub. L. 100-321, § 2(a), 102 Stat. 485 (codified as amended at 38 U.S.C. 1112(c)), if a veteran who participated in a radiation-risk activity while serving on active duty or as a member of a reserve component while on active duty for training or inactive duty training subsequently develops leukemia (other than chronic lymphocytic leukemia), cancer of the thyroid, breast, pharynx, esophagus, stomach, small intestine, pancreas, gall bladder, bile ducts, salivary gland, or urinary tract, multiple myeloma, lymphomas (except Hodgkin's disease), primary cancer of the liver (except if cirrhosis or hepatitis B is indicated), or bronchiolo-alveolar carcinoma, the disease is presumed to be service connected. Section 1112(c)(3)(B) of title 38, United States Code defines "radiation-risk activity" to mean onsite participation in a test involving the atmospheric detonation of a nuclear device; the occupation of Hiroshima or Nagasaki, Japan, by United States forces during the period beginning on August 6, 1945, and

ending on July 1, 1946; or internment as a prisoner of war in Japan or service on active duty in Japan following such internment during World War II which resulted in an opportunity for exposure to ionizing radiation.

The Radiation Exposure Compensation Act (RECA), Pub. L. No. 101-426, 104 Stat. 920 (1990) (codified as amended at 42 U.S.C. 2210 note), authorizes compensation for certain residents of Nevada, Utah, and Arizona who lived downwind from the Government's above-ground nuclear tests, for underground uranium miners, and for persons who participated onsite in a test involving the atmospheric detonation of a nuclear device and contracted a specified disease, including all cancers included in 38 U.S.C. 1112(c)(2). On July 10, 2000, the President signed into law the RECA Amendments of 2000, Pub. L. No. 106-245, § 3, 114 Stat. 501, 502, which expanded the definition of persons eligible to receive compensation to include above-ground uranium miners, millers and persons who transported ore. The RECA Amendments also expanded the list of specified diseases for which compensation is payable to include lung, colon, brain, and ovarian cancers. Other than bronchiolo-alveolar carcinoma (a rare type of lung cancer), No no presumption of service connection currently exists for these four cancers under 38 U.S.C. 1112(c).

Note: Section 1112(c)(2) is slightly broader in that it includes urinary tract cancer not just bladder cancer as RECA does.

On October 30, 2000, the President signed into law the Floyd D. Spence National Defense Authorization Act for FY 2001, Pub. L. No. 106-398, 114 Stat. 1654. Title XXXVI of Pub. L. No. 106-398, the Energy Employees Occupational Illness Compensation Act Amendments of 2000, authorizes compensation and benefits for certain Department of Energy (DOE) employees and persons employed by DOE contractors, subcontractors, and vendors who were involved in DOE nuclear weapons-related programs. Under the Act, if a member of a Special Exposure Cohort develops a "specified cancer" after beginning employment at a DOE facility for a DOE contractor, or at an atomic weapons facility for an atomic weapons contractor, the cancer is presumed to have been sustained in the performance of duty and is compensable. The term "Special Exposure Cohort" refers to employees of DOE or DOE contractors or subcontractors on Amchitka Island, Alaska prior to January 1, 1974, who were exposed to ionizing radiation in