March 10, 2003

Elaine L. Baker
Secretary to the Board
Federal Housing Finance Board
1777 F Street, N.W.
Washington, D.C. 20006

Re: Public Hearing on Unsecured Investments

Dear Ms. Baker:

The Federal Home Loan Bank of Atlanta (FHLBank Atlanta) is filing this written testimony consistent with the notice of public hearing on this topic. The FHLBank Atlanta acknowledges the findings contained in the "Study of Credit Concentrations in the Federal Home Loan Bank System," prepared by William J. Murphy and William E. DiFulvio at the FHLBank Boston, and submitted as part of the record on behalf of all FHLBanks. This testimony supplements the issues addressed in that document.

Purpose of Short-Term Unsecured Investments

Sufficient liquidity is an integral part of each FHLBank's balance sheet. The Federal Housing Finance Board has recognized the important role of liquidity in FHLBank operations, and its regulations require the FHLBanks to maintain contingency liquidity "in an amount sufficient to enable the Bank to meet its liquidity needs, which shall, at a minimum, cover five business days of inability to access the consolidated obligation debt markets."[1] The use of unsecured credit, in the form of overnight and short-term federal funds transactions, is a key component in meeting this requirement. Short-term unsecured investments permit the FHLBanks to deploy this required liquidity pool at positive economic spreads.

Sufficient liquidity allows each FHLBank to warehouse debt at opportunistic prices, thereby reducing the cost of advances to its members. If the FHLBank Atlanta had been forced to rely on discount note funding rather than warehousing of debt, our marginal cost of funding would have increased by approximately four basis points in 2002. This increase would have been passed on to our members through higher advances pricing. In order to obtain the lowest liability costs, the FHLBanks utilize sophisticated liability structures that may be subject to "calls," which accelerate their stated maturities. With the low absolute level of interest rates in 2001 and 2002, the FHLBank Atlanta issued $84.6 billion and $74.8 billion respectively, to refinance liability structures that were called or matured, and to fund asset growth. With this level of activity, sufficient liquidity is imperative to handle daily cash fluctuations.

[1] 12 C.F.R. 932.8

We believe that short-term unsecured investments play an essential role in providing the FHLBanks with operational liquidity at a reasonable cost. At the same time, we recognize that unnecessary short-term debt arbitrage, if employed by a FHLBank, would create undue credit exposure and taint the legitimate purpose of the liquidity pool.

Managing Unsecured Investment Risk

The Federal Housing Finance Board's regulations place limits on the FHLBanks' unsecured investments; such investments may be placed only with highly rated counterparties, and their terms may not extend beyond nine months. The FHLBank Atlanta has adopted even more stringent restrictions on its unsecured investments:

- Unsecured investments may be placed only with those domestic counterparties rated BBB or better and the maturities of investments in such counterparties (excluding government sponsored enterprises or state housing agencies) may not exceed 190 days.
- Unsecured investments may be placed only with those foreign counterparties rated A or better, for a term not to exceed 100 days.

The FHLBank Atlanta believes that these limitations prudently mitigate the risk posed by its own unsecured credit portfolio. Nevertheless, we recognize that the pool of eligible counterparties is small, and that the same counterparties conduct unsecured investment transactions at multiple FHLBanks. More active credit management at the System level could mitigate any System concentration risk that may exist. Therefore, we recommend that the System explore whether a real-time central tracking system could be implemented that, among other things, would monitor System exposure on transactions with terms greater than overnight. While the FHLBank Atlanta believes that the Finance Board should consider limiting or curtailing unnecessary short-term debt arbitrage, we caution against significant reductions in the permitted levels of unsecured borrowings by larger, highly rated counterparties. The perceived risk reductions created by diversification could, in fact, produce a higher risk profile across all portfolios.

We appreciate the opportunity to submit testimony regarding the FHLBanks' unsecured investments, and we look forward to a continuing dialogue with the Finance Board on this important matter.

Sincerely,

Raymond R. Christman