



# FINAL RULE

## FEDERAL HOME LOAN BANK MEMBERSHIP

### FREQUENTLY ASKED QUESTIONS

#### **1. WHAT IS FHFA'S REGULATION ON FEDERAL HOME LOAN BANK MEMBERSHIP?**

FHFA's regulation on Federal Home Loan Bank (FHLBank) membership implements provisions of the Federal Home Loan Bank Act (Bank Act) that establish the requirements an institution must meet to become and remain a member of a FHLBank. The regulation specifies how and when an institution must demonstrate compliance with the statutory membership eligibility requirements and otherwise implements those requirements. The regulation also establishes requirements relating to the membership application process and determination of the appropriate FHLBank district for membership, members' purchase and redemption of FHLBank capital stock, and voluntary or involuntary termination and reacquisition of membership.

#### **2. WHY IS FHFA PUBLISHING THIS FINAL RULE?**

As regulator of the FHLBanks, FHFA is responsible for ensuring the effective implementation of the provisions and purposes of the Bank Act, including those provisions relating to FHLBank membership. In recent years, changes in the financial services industry have raised a number of issues that the existing membership regulation did not sufficiently address. In 2010, FHFA began an extensive review of its membership regulation to determine whether and how the regulation should be revised to address any of those issues. This final rule, as well as the Advance Notice of Proposed Rulemaking, published in December 2010, and the proposed rule published in September 2014, are the result of that review.

#### **3. HOW IS THE FINAL RULE DIFFERENT FROM THE PROPOSED RULE?**

The final rule does not include two provisions from the proposed rule that would have required FHLBank members to maintain ongoing minimum levels of investment in specified residential mortgage assets as a condition of remaining eligible for membership. Also, while the proposed rule would have required FHLBanks to immediately terminate the membership of any captive insurance company that became a member on or after the date the proposed rule was published, the final rule provides for a one-year transition period before the required termination.

#### **4. WHY DID FHFA DECIDE NOT TO INCLUDE THE ONGOING INVESTMENT REQUIREMENTS IN THE FINAL RULE?**

Based on comments received in response to the proposed rule and on research indicating that over 98 percent of current members already comply with both proposed requirements, FHFA determined that the benefit of forcing the remaining two percent of current members to comply with these proposals would be outweighed by the burden the proposed rule would have imposed. While members' ongoing commitment to housing finance is important to ensuring fidelity to the Bank Act, FHFA believes that the statutory requirement for members to continue their commitment to housing finance can be addressed, for the time being, by monitoring the levels of residential mortgage assets they hold.

#### **5. WHY DID FHFA DEFINE "INSURANCE COMPANY" TO EFFECTIVELY EXCLUDE CAPTIVE INSURERS FROM MEMBERSHIP?**

The final rule's definition of "insurance company" is designed to prevent circumvention of the Bank Act. The



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primary business of a captive insurer is underwriting insurance for its parent company or for other affiliates, rather than for the public at large, and captives are generally easier and less expensive to charter, capitalize and operate. The number of entities that are otherwise ineligible for membership in a FHLBank establishing captive insurance subsidiaries as conduits to get low-cost FHLBank funding for the ineligible entity has increased considerably in recent years. Since mid-2012, 27 new captive insurers have been admitted as members, 25 of which are owned by entities that are not themselves eligible for membership. FHFA is concerned that this practice will continue to grow and there is no reason to believe it will not grow to include entities other than REITs, such as hedge funds, investment banks and finance companies, some of which have already inquired about establishing captives to gain access to the FHLBank System.

### **6. WHAT WILL HAPPEN TO ALL THE CAPTIVE INSURERS THAT ARE ALREADY MEMBERS OF AN FHLBANK?**

Consistent with the proposed rule, under the final rule captive insurers that became members prior to publication of FHFA's proposed rule in 2014 will be allowed to remain members for up to 5 years after the effective date of the final rule. For these institutions, the final rule limits outstanding advances during the five-year transition period to 40 percent of the assets of the captive and prohibits new advances or renewals that mature beyond the five-year transition period. Existing advances that mature beyond this transition period will be permitted to remain in place.

Captive insurers that became members after publication of the proposed rule must terminate their memberships within one year following the effective date of the final rule. The final rule allows such captives until the end of that one-year period (or until the date of termination, if earlier) to repay their existing advances, but prohibits them from taking new advances or renewing existing advances that expire during that transition period.

### **7. HOW MANY CAPTIVE INSURERS WILL BE IMPACTED BY THIS RULE? WHAT IS THEIR CURRENT VOLUME OF ADVANCES?**

As of September 30, 2015 there were 40 captive insurers in the FHLBank System.<sup>1</sup> As of November 13, 2015 the total dollar volume of outstanding advances to captive insurers was just over \$35 billion.

### **8. WHAT IS FHFA'S LEGAL AUTHORITY FOR EXCLUDING CAPTIVES?**

Through the Bank Act and the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 (Safety and Soundness Act), Congress gave FHFA regulatory authority over the FHLBanks and gave the Director of FHFA the duty to ensure that each FHLBank complies with the regulations issued under each statute. FHFA has the authority to adopt regulations the Director deems necessary to implement the specific membership provisions of the Bank Act, as well as those the Director deems necessary to ensure that the intent of the statutory membership provisions is accomplished. The authority to ensure that the provisions and purposes of the Bank Act are carried out includes the authority to adopt regulations necessary to ensure that the FHLBanks, their members, or any other parties do not frustrate or subvert the provisions or purposes of the Bank Act.

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<sup>1</sup> Since September 30, 2015, one captive insurer was dissolved and acquired by a non-member, thus terminating its membership.





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### **9. WHY DOES FHFA EXCLUDE CAPTIVE INSURERS FROM MEMBERSHIP EVEN THOUGH REITs THAT SERVE AS PARENT COMPANIES TO MANY CAPTIVES ACTUALLY SUPPORT HOUSING FINANCE?**

FHFA agrees that mortgage real estate investment trusts (REITs) play an important role in the residential mortgage market. However, concluding that channeling of low-cost FHLBank funding to REITs and other ineligible entities through captive members is not authorized by or consistent with the Bank Act, FHFA is compelled to put an end to that practice until such time as Congress authorizes that access.

### **10. WILL FHFA'S FINAL RULE PROHIBIT INSURANCE COMPANIES THAT WRITE POLICIES FOR THE PUBLIC FROM OBTAINING MEMBERSHIP?**

FHFA has taken special care to define “insurance company” so that captives having the characteristics that give rise to the Agency’s concerns will be excluded, while those institutions that do not give rise to such concerns and that would be regarded as carrying out the business of insurance as traditionally understood will continue to be considered insurance companies for purposes of determining eligibility for FHLBank membership.

### **11. WHY DOES THE FINAL RULE REQUIRE INSURANCE COMPANIES TO SUBMIT AUDITED FINANCIALS TO THEIR FHLBANK?**

The Bank Act requires an institution to be in a “financial condition” such that advances can be safely made to it in order to be eligible for membership and the existing regulation already requires the FHLBanks to review the audited financial statements of depository institution applicants. The final rule revises the regulation to require the FHLBanks to obtain and review the audited financial statements of insurance company applicants when assessing the financial condition of the applicant. There are significant benefits to relying on financial statements that have been audited by a third party, particularly when assessing an institution’s financial condition prior to admitting it to membership, the only time at which this requirement will apply.

### **12. WHY DOES THE PLACE OF BUSINESS MATTER FOR AN INSURANCE COMPANY?**

The Bank Act provides generally that an eligible institution may become a member only of the FHLBank in the district in which the institution’s “principal place of business” is located, but does not define that term. FHFA’s existing membership regulation deemed an institution’s “principal place of business” in most cases to be the state in which it maintains its “home office,” but allowed for limited exceptions. Recently, some insurance companies and non-depository community development financial institutions have attempted to apply for membership in the FHLBank whose district included the state under whose laws those entities had been domiciled or incorporated, even though they conducted all of their business activities elsewhere. The final rule therefore retains the “home office” approach and adds a provision requiring the FHLBank to confirm that the institution also conducts business operations from that location. The “principal place of business” provisions will be applied only prospectively and will therefore not affect current FHLBank members.

### **13. WHEN IS THE NEW RULE EFFECTIVE?**

The final rule will be effective 30 days after publication in the Federal Register.

