June 23, 2020

Via Electronic Submission
Federal Housing Finance Agency
Division of Federal Home Loan Bank Regulation
400 7th Street, SW, 7th Floor
Washington, DC 20219

Re: *Federal Home Loan Bank Membership*
Response to Request for Input

Ladies and Gentlemen:

Flagstar Bank, FSB ("Flagstar") appreciates the opportunity to comment on the Federal Housing Finance Agency's February 2020 Request for Input ("RFI") into certain issues related to Federal Home Loan Bank Membership. As the fifth largest bank mortgage originator in the United States, Flagstar has demonstrated its commitment to the mission of the FHLB, and has a unique interest in ensuring that national housing finance markets remain liquid, efficient, competitive, and resilient. Flagstar is also the largest shareholder in the Federal Home Loan Bank of Indianapolis, having an investment of over $300 million in that bank, which represents 18% of Flagstar's Tier 1 capital as of March 31, 2020.

About Flagstar

Flagstar is a federal savings association with approximately $26.8 billion in assets as of March 31, 2020. We provide commercial, small business and consumer banking services through 160 bank branches in five states – Michigan, Indiana, California, Wisconsin and Ohio. Flagstar also has a large mortgage lending business operating through a wholesale network of brokers and correspondents in all 50 states, as well as 87 retail locations in 28 states and a direct lending operation reaching the entire country. In 2019, we generated $33 billion in new mortgage loans. We are also a leading national servicer of mortgage loans and provide complementary ancillary offerings including mortgage servicing rights (MSR) lending, servicing advance lending and MSR recapture services. As of the end of last year, we were servicing approximately $288 billion worth of home mortgage loans representing nearly 1.1 million borrowers.

Responses to Requests for Input

1. General

Flagstar has not identified compelling reasons to change FHLB membership eligibility requirements. FHFA should keep in mind, when considering potential new classes of membership, that as a rule, banks and insurance companies are highly regulated. As a federal savings association, Federal Reserve member, with more than $10 billion in assets, Flagstar is subject to regulation by no fewer than four federal agencies: the Office of the Comptroller of the Currency, the Federal Reserve Board, the Federal Deposit Insurance Corporation, and the Consumer Financial Protection Bureau.

History is replete with examples of how less-regulated entities are not as well equipped to manage interest rate, market and liquidity risks. One need only look to the recent difficulties experienced by non-bank mortgage originators, servicers, and investors, whose lack of capital and liquidity nearly turned the Covid-19 health crisis into a full-blown financial crisis. Those institutions are not regulated like banks, and therefore their ability to manage their interest rate, market and liquidity risks are diminished. Additionally, they lack the capital framework that banks have to protect against the risk of unanticipated loss due to credit, interest rate, market, operational or liquidity risk.

When considering banks, there really can be no question about what it means to "be subject to inspection and regulation under banking, or similar, laws of a state or the United States" or "be in a financial condition such that advances may be safely made to it." Federal and state regulators have long ensured the safety and soundness of banks through the application of well-developed standards. Moreover, FHLBanks should gain comfort knowing that they have access to this examination information in a way that few others enjoy, considering restrictions on the disclosure of confidential supervisory information.

At bottom, Flagstar believes that access to the low-cost wholesale funding that FHLBanks provide is the reward for operating in a safe, sound, highly-regulated manner. If membership is expanded beyond that current, small group of eligible institutions, more reliance must necessarily be placed on the discretion and supervision of the FHLBanks, as opposed to the objective check and balance provided by the regulators of banks and insurance companies. That new paradigm, in Flagstar's opinion, would present increased risk to the FHLBank system and should therefore be avoided.

2. Financial condition requirement

As a general matter, Flagstar believes that FHLBank members' financial condition is adequately assessed by the factors set forth in 12 CFR § 1263.11 and 12 CFR § 1263.16. With respect to banks like Flagstar, it is appropriate to focus on financial statements, capital, a minimum performance standard (CAMELS ratings), earnings, non-performing assets, and allowance for credit losses. These factors, all as set forth in comprehensive regulatory reports of examination to which an FHLBank has access, provide an adequate framework within which to assess the financial health of an organization. It is critical that other current and potential FHLBank members be subject to an assessment that is based on information at least as fulsome as that which banks provide. Moreover, in order to best protect the FHLBanks, when assessing less-regulated entities, a particular emphasis should be placed on capital requirements that are risk-based (that is, the more the assessed risk, the higher the capital requirement) and comprehensive (covering all of the risk taxonomy). Again, we believe it would be difficult for FHFA to manage the assessment of potential new entities without the benefit of the information-sharing available from the regulators of banks and insurance companies, and attempting to do so would introduce unnecessary risk to the FHLBank system.

3. Use of conduit arrangements by ineligible entities

The allowance of technical loopholes that permit otherwise ineligible entities to gain membership should be prohibited as perhaps the most significant risk to the soundness of the FHLBank system. Acting to exclude captive insurance companies from membership is a perfect example of the way in which the FHLBanks should police their membership. The fact that those entities directly or indirectly finance housing does not outweigh suspect or non-existent regulatory oversight and adequate capital relative to their risks. Moreover, banking regulations exist to protect the borrowing entity (for example, Flagstar) from misuse of its resources by its holding company. The same cannot be said, for example, for those real estate investment trust parents of captive insurance companies. This time of economic uncertainty serves to prove the point – banks and insurance companies are generally viewed as having ample capital and liquidity to weather the storm. It is questionable whether non-bank mortgage originators, servicers and investors are in a similar position of strength. The mission of the FHLBanks is best-promoted by those entities that have proven their stability through years of prudential regulation.

Otherwise, Flagstar does not believe it would be necessary to restrict the amount of advances an FHLBank may have outstanding to a traditional FHLBank member. As part of the normal course of prudential regulation, institutions like Flagstar are examined on whether its level of advances from the FHLBank is appropriate. Any effort by the FHFA to impose additional limitations on an already adequately supervised institution would be redundant and therefore unnecessary.

4. Unsupervised members and affiliates

The primary risk that unsupervised entities would bring to the FHLB system is that the confidence in their internal control systems to mitigate inherent credit, interest rate, market, liquidity, operational, and compliance risks is unknown. When there is an unknown level of confidence in the effectiveness of the internal controls, the amount of residual risk cannot be determined and, thus, the adequacy of capital cannot be assessed. We do not believe that the FHFA or the FHLBanks could institute adequate after-the-fact detective controls that could respond in a timely enough manner to provide reliable loss containment in a stress scenario. Lacking that framework, the soundness of the FHLB system could be jeopardized.

5. Nexus to FHLBanks' public policy mission

Flagstar is a federal savings association with a decades-long commitment to housing finance, and has one of the strongest residential mortgage lending platforms in the country. It goes without saying, therefore, that Flagstar stands ready to demonstrate its adherence to the FHLBanks' public policy mission whenever called upon to do so. We would expect that any FHLBank member should be able to demonstrate a similar ongoing commitment to housing finance, and requiring all FHLBank members to make such a showing on demand would be appropriate.

6. Rebuttable presumption approach of regulation

Assuming that membership is appropriately restricted to those entities the FHLBank can be confident are well-supervised, we believe that allowing the FHLBanks to apply judgment, within certain defined limits, is prudent and that those limits provide protection to the safety and soundness of the FHLBanks.

Thank you for the opportunity to share our comments to the RFI. Flagstar values its partnership with FHFA and the FHLBanks, and this opportunity to help strengthen that relationship. If you have any questions concerning this submission, please do not hesitate to contact me at (248) 312-6133 or jim.ciroli@flagstar.com .

Sincerely,

\s\ James K. Ciroli

James K. Ciroli
Executive Vice President &
Chief Financial Officer