

June 23, 2020

VIA ELECTRONIC SUBMISSION ON WWW.FHFA.GOV

Mr. Andre D. Galeano
Deputy Director,
Federal Housing Finance Agency
Division of Federal Home Loan Bank Regulation
400 7th Street, SW
7th Floor
Washington, DC 20219

Dear Deputy Director Galeano:

The American Bankers Association¹ (ABA) is pleased to submit comments on the Federal Housing Finance Agency's (FHFA) request for input (RFI) on Federal Home Loan Bank (FHLB) membership.² The RFI is part of a holistic review of FHLB membership in light of recent developments within the FHLBank System and changes in the nation's housing finance markets. We welcome the FHFA's current membership review to develop a set of principles and requirements of general applicability guided by housing finance and public policy objectives of the FHLBank System.

The RFI follows a final rule issued in 2016 which made a significant change to membership in the System by effectively banning captive insurance companies from membership in the System. ABA submitted comments³ on that proposal, noting that we share FHFA's concerns about the use of captive insurance companies as conduits for otherwise ineligible members to gain entry to the System. However, we took issue with FHFA's approach, raising concerns that deeming captive insurers as ineligible for membership ran counter to the clear meaning of the statute. ABA also objected to the proposal to impose ongoing tracking of mission related activities by members. We appreciate FHFA's decision to reconsider both topics, and offer member feedback on both subjects, which is consistent with that expressed in our previous comment letter.

¹ The American Bankers Association is the voice of the nation's \$15 trillion banking industry, which is composed of small, regional, and large banks that together employ more than 2 million people, safeguard \$11 trillion in deposits, and extend more than \$8 trillion in loans. ABA's members represent the full range of federally insured banking institutions and their subsidiaries and make up the vast majority of the members of the Federal Home Loan Bank System.

² Fed. Hous. Fin. Agency, Div. of Fed. Home Loan Bank Regulation, Federal Home Loan Bank Membership: Request for Input (Feb. 2020), <https://www.fhfa.gov/Media/PublicAffairs/PublicAffairsDocuments/RFI-on-FHLBank-Membership.pdf>.

³ See Letter from Joseph Pigg, Am. Bankers Ass'n, to Alfred M. Pollard, Fed. Hous. Fin. Agency (Jan. 12, 2015), <https://www.aba.com/-/media/documents/comment-letter/abacommentstofhfaonfhlbmembershiprequirements1122015.pdf?rev=74319e616176495abb02a4482e8c1475>.

General Membership Eligibility

As FHFA appropriately notes, the categories of eligible System members is established in the statute by Congress. FHFA should not, unless clearly and specifically directed by Congressional statute, authorize expanded membership to other entities that are not already authorized by statute.

These are the overriding principles that must inform FHFA's regulation of membership eligibility. FHFA should take no action that circumvents or otherwise thwarts the intent of Congress. Entities deemed eligible for membership by Congress should not be made ineligible through regulatory fiat as was done with regard to all captive insurance companies under the previous rulemaking. Instead, FHFA's focus should be on ensuring that all members deemed eligible by Congress are allowed into the System in a manner that protects the overall safety and soundness and mission of the System.

Therefore, we support the approach outlined in the RFI, which recognizes that membership eligibility requirements must be "guided by the twin objectives of ensuring that the System remains safe and sound and able to provide liquidity for housing finance through the housing and business cycle and ensuring that all members have an appropriate nexus to the housing finance and community development mission of the FHLBanks."

Safety and Soundness

Judged by these standards, we believe FHFA should revisit its previous decision to deny all captive insurance companies membership. Instead, FHFA should be guided by Congressional intent to allow these insurance companies membership in the System, but FHFA should limit each individual captive insurer's ability to access the System based upon its potential to impact the safety and soundness of the System.

The Federal Home Loan Bank System is a cooperative with joint and several liability. Therefore, a paramount duty of FHFA is to ensure the safety and soundness of the System in order to protect eligible existing members' capital investment in, and ability to access, the System. As a general rule, a basic requirement that members be subject to prudential regulation reduces credit risk within the System and protects the FHLBanks' ability to access global capital markets. However, FHFA should also acknowledge that prudential regulation and examination standards for eligible members differ significantly. Not all entities eligible for membership in the FHLBs are subject to the same regulatory requirements or to comparable regulatory oversight and examination as provided by the OCC, FDIC, Federal Reserve and state banking regulators.⁴

We believe FHFA should factor differences in prudential regulation and supervision into its regulation of member access to the system and adjust eligible members' System access as needed to protect all members' capital investment. Where Congress has designated entities that are not subject to prudential regulation as eligible members, FHFA should consider a parent organization's prudential regulation, if applicable. For example, member access standards should differ for a captive insurer owned by a

⁴ For example, in a 2019 letter to the leadership of the National Credit Union Association, the regulator of federal credit unions, ABA noted that "NCUA regulation and supervision is substandard and poses increasing risks to the credit union system." Letter from Rob Nichols, Am. Bankers Ass'n, to Rodney E. Hood et al., Nat'l Credit Union Admin. (June 27, 2019), <https://www.aba.com/-/media/documents/letters-to-congress-and-regulators/ncua-equality-report062719.pdf?rev=ad2e52d1564646e1ba54215eb3f02378>.

Federally regulated and supervised depository institution versus a captive insurer owned by an entity not subject to prudential regulation and capital standards sufficient to protect against the potential losses that member could present to the System and its members. In the latter example, it is conceivable that a captive insurer, owned by a parent without sufficient regulation or capital, could be technically eligible for membership in the System but effectively unable to borrow, due to the risks such borrowing might present. Similarly, we recommend that FHFA establish clear, consistent, and risk based member access standards that account for differences in prudential regulation such as for less stringently regulated credit unions and for non-depository CDFI's.

To further safety and soundness for all eligible members, FHFA should continue to allow, and indeed, encourage, the development of sound, risk-based collateral policies by each of the individual Federal Home Loan Banks that protect the individual Bank and its members based upon the risk profile of the borrowing member. These member access standards include overcollateralization and actual delivery of collateral, as well as a requirement to share reports of examinations with the FHLBank, among other possible requirements.

Mission Adherence

As noted in our previous comment, rules for ensuring the adherence to the mission of the System currently exist. Imposing a further on-going test is unnecessary and would in fact hinder the effectiveness of the System.

Under current requirements, a member may only borrow from a FHLB if it has eligible collateral to pledge. If a member does not make sufficient mission related loans, or hold sufficient mission related assets, it will not have collateral to pledge and will not be allowed to borrow further. This approach is both efficient and elegant as it requires no on-going tracking and allows members maximum flexibility while also ensuring a focus on the broader mission of the System.

The approach of tying *use* of the System (not eligibility for membership) to availability of eligible collateral is an effective way of ensuring adherence to the System's mission. Conversely, imposing a test for membership tied to an ongoing commitment runs counter to Congressional intent and to the effective functioning of the System. Again, eligibility is determined by Congress. Eligible members remain eligible regardless of whether they are fulfilling the mission of the System, but their ability to *access* the System is tied to whether they are fulfilling that mission. A member that holds no mortgage loans or other eligible collateral on their books remains an eligible member of the System (by statute) but is unlikely to be able to make effective use of that membership, as they would lack sufficient collateral to pledge for borrowing.

We must also note that the uncertainty over continued membership eligibility that would be injected into the System through the imposition of an ongoing test would harm the entire Federal Home Loan Bank System. Under such an approach, as members fall out of eligibility, their stock in the FHLB must be redeemed, destabilizing the capital of the individual Banks. Moreover, because the System is a joint and several one, the uncertainty would introduce risk to the entire FHLB System. While this may seem inconsequential on an individual bank basis, taken at scale, the entire System will be viewed by prudential bank regulators and the capital markets as less stable and less reliable, to the detriment of all members of the System and to the nation's financial structure overall.

Use of the System

Any eligible member (as determined by Congress) that meets the safety and soundness and mission adherence requirements described above should be able to access the System in line with the policies and procedures required by each FHLB and the FHFA to effectuate those requirements. There should be no additional limits based upon a member's size, concentration, or potential to be used as a conduit by other entities. Instead, the risks each member brings to the System, both generally and specifically regarding their use of System advances, as well as the information available as to their prudential regulation, should be taken into consideration as factors impacting their ability to access the System. The FHFA should not impose additional restrictions on any member or class of members not based upon actual risk presented.

Conduits

Entities that are not otherwise eligible for membership in the System, as defined by Congress, should not be able to access the System through a "back door" or conduit relationship with an eligible member. This principle should hold true regardless of the ineligible entity's nexus to the mission of the System. In many instances, those seeking to gain access to the System do engage in activities that are consistent with the housing and community development mission of the System, but they are structured in a manner inconsistent with the safe and sound operation of the cooperative structure of the System. They lack capital and other prudential safeguards that would make their access to the System a significant risk to the System and its members. Absent these safeguards, Congress has not expanded membership eligibility to these entities to protect the existing capital investment in, and usage of the System by current members. Allowing these entities to access the System through a conduit would undermine Congressional intent *and* subject the System and its members to undue risks.

FHFA has posed the question of whether members with a high likelihood of being used as conduits by such entities should be restricted from borrowing or membership in the System. While ABA recognizes both the risks to the System posed by such conduit arrangements and the challenge of regulating the System to prevent improper conduit arrangements, we feel strongly that prohibiting membership to the System by any class of otherwise eligible members based upon these concerns is improper. Doing so substitutes the FHFA's judgement for that of Congress. Potentially restricting borrowing by such members may be appropriate, as discussed above in the context of safety and soundness. Such determinations must be made on a case-by-case basis depending upon the risk that such borrowing presents to the System and its members. If an otherwise ineligible member lacking regulation, oversight and capital attempts to use an eligible member as a conduit, safety and soundness considerations must dictate that the FHLB and the FHFA restrict access by the eligible member to protect the System. FHFA and the individual FHLBs must remain vigilant in monitoring members' use of the System and adjust collateral and other requirements to safeguard against the risk each members' borrowing poses.

Conclusion

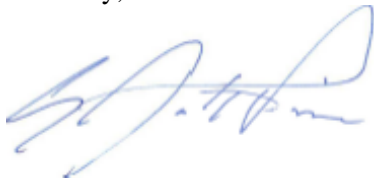
The importance of the Federal Home Loan Banks as a source of liquidity and other services to ABA's members cannot be overstated. For the better part of the last century the Federal Home Loan Banks have met those needs in a safe, sound, and efficient manner. Congress has, over that time, expanded eligibility

for membership in the System, and has changed the regulator of the System. Even the number of FHLBanks and their locations has changed. What has not changed is the fundamental cooperative structure of the System and the attendant joint and several liability of members—both of which serve to ensure safe, sound, and mission compliant use of the System. We very much appreciate FHFA’s commitment to ensuring that the System remains strong and available for all eligible members.

With that said, we caution FHFA not to overreach the statutory bounds of membership (and urge a revisiting of past overreaches), and urge reliance on the elegance and efficiency of the collateral based borrowing requirements to ensure mission adherence. Adhering to Congressional intent while also exercising vigilant and appropriately focused regulation will ensure that the Federal Home Loan Banks continue effectively serving their members for many decades to come.

We appreciate this opportunity to comment. If you have questions or wish to discuss these matters in more detail, please contact the undersigned.

Sincerely,

A handwritten signature in blue ink, appearing to read "G. Joseph Pigg". The signature is fluid and cursive, with a large initial "G" and "J".

G. Joseph Pigg
Senior Vice President, Fair & Responsible Banking
Regulatory Compliance and Policy