



June 23, 2020

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

Regarding: Federal Home Loan Bank Membership – Request for Input

Dear Deputy Director Galeano:

The Community Bankers Association of Illinois (“CBAI”), which proudly represents 300 Illinois community banks, appreciates the opportunity to comment on the Federal Housing Finance Agency (“FHFA” or “Agency”) request for input (“RFI”) regarding Federal Home Loan Bank (“FHLBanks” or “Banks”) membership. CBAI acknowledges the stated goals of the FHFA’s membership review is to develop a set of principles and requirements to address membership issues “on a consistent basis, guided by the twin objectives of ensuring the [FHLB] System remains safe and sound and be 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.” CBAI appreciates the FHFA considering what actions may be appropriate to address membership issues and that any changes would be addressed through subsequent formal rulemaking.

CBAI is dedicated to exclusively representing the interests of Illinois community banks and thrifts through effective advocacy, outstanding education, and high quality products. CBAI’s members hold more than \$75 billion in assets, operate 940 locations statewide, and lend to consumers, small businesses, and agriculture. For more information, please visit www.cbai.com.

Background

The Federal Home Loan Bank System (“FHLBSystem”) and its individual banks are government sponsored entities that were created by Congress in 1932 with a mission to provide reliable sources of funding for housing finance and community investment. The FHLBSystem contains 11 districts. The FHLB-Chicago serves Illinois and Wisconsin and its membership includes approximately 465 banks and 70 thrifts. Specifically, the FHLBanks provide short-term liquidity, long-term funding, mortgage-related products, and other financial services in order to help their members provide affordable credit to the local communities they serve. The vast majority of CBAI members are shareholder/members of the FHLB-Chicago. The regional structure, special functions, and unique purpose of the FHLBanks are important to the nation, and must be recognized, supported, and maintained by policymakers.

Membership

CBAI has long been involved with policymakers on FHLBank membership issues. CBAI believes Congress has the ultimate authority to determine the type of entities that should be members of the FHLBanks. It is important to note that three times (i.e., in 1989, 2008 and 2015) Congress expanded the list of institutions eligible for membership in the Banks. It is equally important to note that not once has Congress restricted or terminated a class of members from Bank membership. Unfortunately, a membership restriction was unilaterally imposed by the FHFA in January of 2016 with the regulatory expulsion of captive insurance companies (“Captives”), not only from future membership consideration but it also terminated existing Captives membership in FHLBanks. The fact that Captives have been and will be expelled in an orderly fashion (i.e., within either in one or five years depending on their length of the membership) does not diminish the inappropriateness of their expulsion.

CBAI remains greatly concerned by the Agency’s final rule (“Final Rule” or “Rule”) that terminated Captives’ FHLBank membership. The Agency also had proposed an ongoing mortgage asset test versus the longstanding three pronged membership eligibility test. If the Rule had been adopted in its entirety it would have had a profound impact on the FHLBSystem, FHLBanks and its members including but not limited to: an increased regulatory burden; difficulties in member balance sheet management; the stability of the FHLBSystem and its continued reliability as a funding partner particularly in times of economic stress; uncertainty about continuing member access to liquidity; the future value of Bank membership; the

implications for membership decisions; and the impact on housing and community development throughout the FHLBSystem.

If this Rule had been implemented in its entirety, the regulatory compliance burden of monitoring and complying with the ongoing membership eligibility requirements would have fallen disproportionately hard on community banks and thrifts. In addition, these banks and thrifts would have faced uncertain access to a reliable source of liquidity with fewer available alternate sources of liquidity, and greater difficulties in liquidity management and contingency planning. Thankfully, the ongoing mortgage asset test was justifiably not included in the Rule and CBAI recommends that it not be proposed again.

What was not struck from the Final Rule, and what was particularly disturbing to CBAI, was the termination of existing Captives from membership in FHLBanks. This decision unfortunately established a precedent that the FHFA can unilaterally change the membership rules which existing members relied on when they made their membership decisions and which these Captive members reasonably believed were sacrosanct. This *after the fact* changing of the rules cannot be ignored by prospective or existing members. Their logical question is “Who will be next?” This Rule has resulted in a devaluation of FHLB membership, a disincentive to become a Member, a smaller and less efficiently operating FHLBSystem, fewer profits, and a less effective contribution by the FHLBSystem to the funding for housing finance and community investment. This cannot possibly be consistent with the mission of the FHFA – which is to ensure the housing GSEs (including the FHLBanks) “serve as a reliable source of liquidity and funding for housing finance and community investment.” This Rule was inappropriate, it is harmful to its members and the FHLBSystem, and CBAI recommends that it be reversed at least for the five-year Captives whose memberships in their FHLBanks predated this restrictive rulemaking.

Any changes to FHLBank membership by the FHFA, especially those which would restrict existing membership, should come from Congress. As stated earlier, when Congress has considered FHLBank membership in the past, the results have been to expand and not contract membership in the FHLBanks. This is particularly true at this time when Congress is continuing to review the structure of housing finance system, Fannie and Freddie are in the early stages of preparing to finally exit government conservatorship, there is a review of the important role served by FHLBanks as a provider of member products and services, and when financial institutions and government agencies are being mightily challenged in their response to the COVID-19 crisis.

CBAI continues to have concerns about an inappropriate application of membership rules, because, unfortunately, it has happened in the recent past with the expulsion of existing Captives from FHLBank membership. CBAI urges caution by the FHFA in crafting membership proposals to be mindful its own mission, and of past Congressional actions which have been to expand (never once contract) eligibility for membership in FHLBanks.

Safety and Soundness

The safety and soundness of the FHLBSystem is paramount and must be maintained, particularly with the joint and several liability of the obligations of FHLBanks. Clear guidelines for maintaining access to financial information, establishing financial benchmarks, meaningful consequences for falling short of those benchmarks, sufficient pledged liquid collateral, the ability to control and liquidate that collateral if necessary, and flexibility to quickly react to changing economic conditions must be required for each membership relationship.

The track record of the FHLBanks is excellent and they have served their members exceedingly well during past financial crises and during the current COVID-19 crisis. There appears to be no glaring inadequacies in the current FHLBSystem and it has demonstrated its ability to adapt to new challenges. Therefore, no Agency driven, wholesale, supervision and regulatory changes are necessary and the Banks should be reasonably trusted to continue to adapt as they feel necessary (with appropriate Agency supervision) to ever changing and differing regional circumstances.

New Members

A healthy FHLBSystem will need to reasonably evolve as circumstances change in financial services, and housing and related industries. In much the same way as the banking industry benefits from new entrants (i.e., de novo banks), the FHLBanks and the FHLBSystem benefits from new members (within Congressionally approved guidelines). Similar challenges are faced by banking regulators with the development of the FedNow Service to modernize the payments system which is in response to new technology and consumer payment preferences, and the modernization of the Community Reinvestment Act to highlight and retain the relevant parts of the CRA, identify missed opportunities for additional credit, reduce the regulatory burden, and hopefully include all financial service providers for compliance.

CBAI opposes membership for entities that are otherwise ineligible for membership and their using the back door to gain entry to the FHLB System and its many benefits. This position is entirely consistent with CBAI's opposition of fintechs, commercial firms and social media giants from gaining a back door entry to banking through Industrial Loan Companies and the OCC's Special Purpose National Banks charters; or large in-store or on-line retailers and fintechs from gaining direct access to the nation's payments system. If these institutions want to offer banking services and otherwise benefit from being a regulated financial institution (i.e., a bank), they should not be able to escape the regulatory requirements to which banks must comply. The financial services playing field is already skewed against community banks and thrifts by tax-exempt credit unions and the Farm Credit System. Another competitive disadvantage for community banks and thrifts must be avoided.

While it may appear to be a contradiction that some Captive owners were not themselves eligible for membership in FHLBanks yet CBAI objected to their being expelled from membership, that is not the case. The Captives being expelled had been previously approved and many had been members of their FHLBank for over a decade. A prospective exclusion is a different matter, but expelling existing members, whose membership predated even the earlier membership proposal, was unconscionable.

In a rapidly evolving marketplace, it will admittedly be difficult for rigid and universal guidelines to stand the test of time. There must be some flexibility to approve new members (outside of regulated financial institutions) within reasonable bounds and Congressional intent. However, certain guideposts must be followed to assure the safety and soundness of the FHLB System, and to strictly maintain its mission focus, when considering the approval of any new application for membership in the Banks. No institution should be treated differently and certainly not more favorable than the current FHLBank members. These necessary application or eligibility requirements for membership must include the following in addition to the existing requirements of the FHLB Act and regulations.

- Applicants must have an established and successful business model which has resulted in strong financial performance, including consistent profitability, and robust capital and liquidity.
- These positive financial results should be confirmed with audited financial statements (unqualified opinion) by nationally recognized CPA firms.

- If approved for membership the financial stability of the new members must be consistently monitored by the Banks.
- There must be a legitimate need for the focused services of the Bank.
- There must be a strong commitment to the FHLBSystem's and Banks' mission (i.e., nexus to housing finance and community development).
- Their commitment to housing must be demonstrated with the satisfaction of the three pronged membership eligibility tests.
- There must be a commitment to ownership in the regional Bank in order to have their capital investment at risk or "*skin in the game*".
- Sufficient assets must be pledged to secure advances and other Bank services.
- The Banks must have the ability to modify the collateral advance ratios on pledged assets in response to the risks posed by the members from (but not limited to) changing financial condition and results of operation.
- Advances and services must be collateralized by mission consistent assets.
- The Banks must have immediately access and the ability to control and liquidate pledged collateral in the event of a member bankruptcy.
- The advances must be used for mission consistent purposes.
- Sufficient oversight by the Banks should confirm compliance with the Bank's and FHLBSystem's mission purpose.
- A significant challenge with new proposed non-financial institution members will be reconciling the quality of their different or non-existent regulatory regimes to what regulated financial institutions are subject to.
- An additional challenge in the event of the failure of a non-financial institution (as stated above) will be the ability of the Banks to have immediate access to and liquidate the

collateral securing the FHLBank advances and other financial products and services. This process must be similarly as effectively as the FDIC and NCUA receivership process in the event of a failure of a bank or credit union.

A goal of these rules and requirements is to build a member relationship that is incentivized to use the borrowed funds for mission critical purposes and that not doing will be counterproductive to joining an FHLBank in the first place.

Conclusion

The restrictive membership requirements from the 2016 proposed rule were unprecedented, unnecessary, and resulted in harmful changes to membership in FHLBanks. CBAI recommends the FHFA not unilaterally exclude any class from membership, and not impose an ongoing mortgage asset test for FHLBank membership. CBAI further recommends that Congress should dictate major membership decisions. Additionally, CBAI recommends the FHFA maintain a reasonable degree of flexibility, in developing a set of principles and requirements of general applicability for membership while maintaining the rigorous safety and soundness standards and the housing and community development mission focus that has served the FHLBSystem and its members for many decades.

Thank you for the opportunity to provide this input. We appreciate the FHFA considering our observations and recommendations. If you have any questions or need additional information, please do not hesitate to contact me at (847) 909-8341 or davids@cba.com .

Sincerely,

/s/

David G. Schroeder
Senior Vice President
Federal Governmental Relations