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VIA ELECTRONIC SUBMISSION

June 23, 2020

Director Mark Calabria, PhD
Attn: Comments to FHLB Membership Request for Input
Federal Housing Finance Agency
Division of Federal Home Loan Bank Regulation
400 7th Street SW, 7th Floor
Washington, D.C. 20219

Re: Federal Home Loan Bank Membership of Captive Insurance Companies
Starwood Property Trust, Inc. and Prospect Mortgage Insurance, LLC

Dear Dr. Calabria:

On behalf of Starwood Property Trust, Inc. ("Starwood") and its wholly owned indirect subsidiary, Prospect Mortgage Insurance, LLC ("PMI"), this letter is submitted in response to the Request for Input regarding Federal Home Loan Bank membership published by the Federal Housing Finance Agency ("FHFA") in February 2020.

Insurance companies have been eligible to be members in the Federal Home Loan Banks ("FHLBs") since the original Federal Home Loan Bank Act (the "Bank Act") was enacted in 1932. The Bank Act, as originally enacted and as still in effect today, provides that "[*a*]*ny* building and loan association, savings and loan association, cooperative bank, homestead association, *insurance company*, savings bank, community development financial institution, or any insured depository institution . . . shall be eligible to become a member of a Federal Home Loan Bank" (emphasis added).[1]

The Bank Act does not define "insurance company," and neither the FHFA nor its predecessor agencies had, prior to 2016, adopted a regulatory definition of that term. Historically, the FHFA had permitted any entity chartered or licensed as an "insurance company" under state law and that met the other applicable requirements to become an FHLB member. Because captive insurance companies, which underwrite insurance risks of affiliated companies, are chartered or licensed as insurance companies under the laws of states that have enacted captive insurance statutes, a

[1] 12 U.S.C. § 1424(a)(1); 12 C.F.R. § 1263.6(a).

number of captive insurers, including Starwood's captive insurer entity, had been permitted to become FHLB members under the FHFA's pre-2016 rules.

In 2016, the Federal Housing Finance Agency ("FHFA") adopted a final rule defining the term "insurance company" for purposes of the Bank Act to exclude captive insurers, thereby rendering captive insurers ineligible for FHLB membership (the "Captive Exclusion Rule").[2] Despite the FHFA's assertions to the contrary, however, the FHFA lacked the legal authority to adopt the Captive Exclusion Rule based on established principles of statutory interpretation and administrative rulemaking procedures. Accordingly, the FHFA should repeal the Captive Exclusion Rule and restore FHLB membership eligibility to captive insurers based on the clear application of statutory eligibility for "*any…insurance company*" or, in the alternative, permanently grandfather captive insurance companies that are currently FHLB members in good standing.

I. Background

A. Background on Prospect Mortgage Insurance, LLC

PMI was created as a Vermont limited liability company in May 2009, as a subsidiary of Prospect Mortgage, LLC, and was licensed as a "captive insurance company" under applicable Vermont law (Chapter 141 of the Vermont Banking and Insurance Statutes). In February 2010, PMI became a member of the Federal Home Loan Bank of Chicago. From 2010 to 2017, PMI continued (as a subsidiary of Prospect Mortgage, LLC) as a member in good standing of the Federal Home Loan Bank of Chicago and as a licensed captive insurance company in good standing under Vermont law.

In early 2017, Starwood and PMI began active discussions regarding a potential acquisition of PMI by Starwood. In the course of these discussions, the Federal Home Loan Bank of Chicago conducted a review of PMI's capitalization plan (which, at the time, was associated with a borrowing limit from the Federal Home Loan Bank of Chicago of $500 million). Starwood completed its acquisition of PMI on July 7, 2017 and, following completion of the acquisition, capitalized PMI in accordance with a capitalization plan approved by the Federal Home Loan Bank of Chicago (with oversight by the FHFA).

In early 2019, PMI again engaged with the Federal Home Loan Bank of Chicago to discuss increasing PMI's capital base in connection with an associated increase in PMI's FHLB borrowing capacity (from $500 million to $2 billion). In connection with these discussions, PMI engaged in monthly correspondence with state regulators on specific compliance and reporting requests by the Federal Home Loan

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[2] 81 Fed. Reg. 3246, 3249 (January 20, 2016) ("FHFA Final Rule").

Bank of Chicago, and provided monthly approved financial reports to the Federal Home Loan Bank of Chicago.

As of the date of this letter, PMI continues to be a member in good standing of the Federal Home Loan Bank of Chicago and a licensed captive insurance company in good standing under Vermont law, subject to a host of regulations and supervisory oversight requirements under Vermont law. Throughout the recent pandemic, PMI has demonstrated strong financial resiliency, with a regulatory capital surplus of almost $1 billion (as of May 31, 2020).

B. Background on FHFA Exclusion of Captive Insurance Companies

Despite the long-standing acceptance of captive insurers as eligible FHLB members, in June 2014, the FHLBs jointly agreed to a three-month moratorium on admitting captive insurers to the FHLB system. During this moratorium, the FHFA issued a proposed rule in September 2014 (the "Proposed Rule") to, among other things, define the term "insurance company" to mean only companies "whose primary business is the underwriting of insurance for nonaffiliated persons or entities," and thereby exclude captive insurers from FHLB membership eligibility.[3] This exclusion of captive insurers had been contemplated by the FHFA at least as early as December 2010, when the FHFA published an Advance Notice of Proposed Rulemaking ("ANPR") discussing and requesting comment on a number of ways to revise its membership regulation, including with respect to the scope of insurance companies eligible for FHLB membership. As discussed in the ANPR, the FHFA had been motivated to consider the exclusion of captive insurance companies from FHLB membership primarily due to concerns as to (i) whether captive insurers are subject to the degree of supervision and examination contemplated by the Bank Act, and (ii) whether captive insurers have a *bona fide* involvement in supporting housing finance.[4]

The FHFA received 137 comment letters in response to the ANPR, almost all of which opposed revising the FHLB membership regulation, and received approximately 400 comment letters addressing the Proposed Rule's exclusion of captive insurers from FHLB membership "with about 60 of those letters treating the issue in some depth" and with "[a]lmost all of the letters express[ing] opposition to all aspects of the captives proposal."[5] In spite of this degree of public opposition, in January 2016 the FHFA adopted the narrow definition of "insurance company" largely as proposed under the Proposed Rule, thereby excluding from FHLB membership eligibility captive insurance companies whose primary business is the underwriting of insurance for

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[3] 79 Fed. Reg. 54848, 54853 (September 12, 2014) ("FHFA Proposed Rule"); *see also* FHFA Final Rule at 3249.

[4] 75 Fed. Reg. 81145 (Dec. 27, 2010).

[5] FHFA Proposed Rule at 54850.

affiliated persons or entities.[6] This Captive Exclusion Rule included a transition provision permitting captive insurers that became members prior to the publication date of the Proposed Rule to remain FHLB members for five years, and those that became members after the publication date of the Proposed Rule to remain FHLB members for one year, in each case after the effective date of the final rule (subject to limitations on outstanding and new advances).

II. Plain Meaning Interpretation of Bank Act

Because the Captive Exclusion Rule is fundamentally an interpretation by the FHFA of the scope of FHLB membership eligibility prescribed under the Bank Act's statutory text, the FHFA's authority to adopt the Captive Exclusion Rule depends on whether the FHFA's interpretation of the Bank Act was proper under established canons of statutory construction and whether courts would defer to the FHFA's interpretation of the Bank Act under established principles of judicial deference.

A. "Plain Meaning Rule" of Statutory Interpretation Supports FHLB Eligibility for Captive Insurers

In interpreting statutory language, courts have used a number of canons of construction to determine the meaning intended by Congress.[7] However, "in all statutory construction cases, [a court] begin[s] with the language of the statute."[8] When examining the language of the statute, courts typically adhere to a long-held fundamental principle of judicial interpretation—which has come to be known as the "plain meaning rule"—that "where the language of an enactment is clear, and construction according to its terms does not lead to absurd or impracticable consequences, the words employed are to be taken as the final expression of the meaning intended."[9]

Although the plain meaning rule has been articulated in a number of ways, its essential aspect is that there is no need to "interpret" unambiguous statutory language. Under this rule, courts have found it unnecessary to resort to legislative history (such as reports, hearings, and debates), consider the meaning of a particular provision against the broader purpose of a statute, or look to such "intrinsic" material (such as the statute's title or preamble), which would only serve to "cloud a statutory text that is

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[6] FHFA Final Rule at 3279.

[7] *See*, *e.g.*, LARRY EIG, CONG. RESEARCH SERV., STATUTORY INTERPRETATION: GENERAL PRINCIPLES AND RECENT TRENDS (2014) (describing a number of "language" and "substantive" canons of statutory construction).

[8] *Barnhart v. Sigmon Coal Co.*, 534 U. S. 438, 450 (2002).

[9] *United States v. Missouri Pac. R.R.*, 278 U.S. 269, 278 (1929); *see also Caminetti v. United States,* 242 U.S. 470, 485 (1917) ("[T]he meaning of a statute must, in the first instance, be sought in the language in which the act is framed, and if that is plain . . . the sole function of the courts is to enforce it according to its terms.").

clear."[10] Instead, the court's inquiry ceases "if the statutory language is unambiguous and 'the statutory scheme is coherent and consistent.'"[11]

Under a proper textual analysis of the Bank Act's scope of FHLB membership eligibility that begins with the "plain meaning of the statute," the Bank Act is unambiguous: "*any…insurance company*" is eligible for FHLB membership, and the meaning of "insurance company" as provided under the statute's plain meaning encompasses all types of companies that provide insurance.

1. Definition of "Insurance Company"

Although the term "insurance company" is not defined in the Bank Act, agency guidance has previously indicated that an "insurance company" eligible for FHLB membership under the Bank Act includes any company that engages in underwriting insurance risk, without distinguishing between particular business models or corporate structures of insurance underwriters.[12] Consistent with this interpretation, any entity chartered or licensed as an "insurance company" under state law and that has met the other applicable requirements historically has been permitted to become an FHLB member.[13] Because captive insurance companies, which primarily underwrite insurance risks of affiliated companies, are chartered or licensed as insurance companies under the laws of states that have enacted captive insurance statutes, a number of those types of entities have been permitted to become FHLB members as "insurance companies" within the meaning of the Bank Act.

In addition, captive insurance companies have repeatedly been found to be engaged in the "business of insurance" in other regulatory contexts. For example, courts have found a captive insurance company to be engaged in the business of insurance based on the corporate separateness of the captive insurer from its parent entity and the fact that it issued documents "that have all the indicia of insurance policies."[14] Similarly, courts have found a captive insurance company to qualify as an "insurance company" where the captive insurer was a *bona fide* captive insurance company under the chartering state's law, with a valid business purpose and sufficiently capitalization to

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[10] *Ratzlaf v. United States*, 510 U.S. 135, 147–48 (1994).

[11] *Barnhart v. Sigmon Coal Co.*, 534 U. S. 438, 450 (2002) (quoting *Robinson v. Shell Oil Co.*, 519 U. S. 337, 340 (1997)); *see also Connecticut Nat'l Bank v. Germain*, 503 U. S. 249, 253–254 (1992); *United States v. Ron Pair Enters., Inc.*, 489 U. S. 235, 240–41 (1989).

[12] Federal Housing Finance Board, Op. Gen. Counsel, 1998-GC-12, at 1 (Sept. 18, 1998), *available at* https://www.fhfa.gov/SupervisionRegulation/LegalDocuments/Documents/FHFB-General-Cousnel-Opinions/1998/1998-GC-12.pdf

[13] *See* FHFA Final Rule at 3254 (noting that the first captive insurance company FHLB member was admitted to FHLB membership in 1994).

[14] *See, e.g.*, *Lemos v. Electrolux N Am., Inc.*, 937 N.E.2d 984 (Mass. App. Ct. 2010).

cover all of its insurance obligations.[15] Importantly, federal appeals courts have concluded that "nothing of substance would differ [the business of a captive insurer] from the purchase of insurance from an unrelated insurance company," and that captives "performed all of the functions of an insurer."[16]

2. Scope of "Any" Insurance Company

Because captive insurers have widely been accepted as "insurance companies," such captive insurers are within the scope of FHLB membership eligibility that extends under the Bank Act to "any" insurance company. The Supreme Court has recognized that "the word 'any' naturally carries 'an expansive meaning.'"[17] When used (as here) "with a 'singular noun in affirmative contexts,' the word 'any' ordinarily 'refer[s] to a member of a particular group or class *without distinction or limitation*.'"[18] In this way, the Bank Act's specification that "*any*" insurance company is eligible for FHLB membership "'impl[ies] *every* member of the class or group'" of "insurance companies" is included in the statutorily provided scope of FHLB membership eligibility, including captive insurance companies.[19]

3. "Plain Meaning Rule" Conclusion

After decades of Congress, the FHLBs, the insurance industry and the FHFA itself operating under a common understanding regarding the Bank Act's scope of FHLB membership eligibility with respect to insurance companies, the Captive Exclusion Rule attempted to introduce ambiguity where there is none.[20] Despite the FHFA's claim that the absence of Congressionally defined parameters on the scope of "insurance companies" eligible for FHLB membership leaves the term "insurance company" ambiguous, any such parameters have been unnecessary precisely because the Bank Act unambiguously extends the scope of FHLB membership eligibility to *any* insurance company (without regard to the insurance company's particular structure, products or business model).

Accordingly, the plain statutory language should be taken as the final expression of the meaning Congress intended with respect to the FHLB membership eligibility of captive insurers.

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[15] *Wendy's Int'l, Inc. v. Hamer*, 996 N.E.2d 1250 (Ill. App. Ct. Oct. 7, 2013).

[16] *Amerco, Inc. v. Comm'r IRS*, 979 F.2d 162, 168 (9th Cir. 1992).

[17] *SAS Inst., Inc. v. Iancu*, U.S. 138 S. Ct. 1348, 1354 (2018) (quoting United States v. Gonzales, 520 U.S. 1, 5 (1997)).

[18] *Id.* (emphasis added) (quoting Oxford English Dictionary (3d ed., Mar. 2016)).

[19] *Id.* (emphasis in original).

[20] FHFA Final Rule at 3261 ("[C]hanging factual circumstances have generated an ambiguity in the term 'insurance company.'").

B. Judicial Deference Not Available for FHFA Captive Exclusion Rule

In the event that a court were to review the FHFA's interpretation of the Bank Act eligibility for insurance companies under existing principles of agency deference, a court likely would find deference unwarranted for the FHFA's regulatory exclusion of captive insurance companies from FHLB membership eligibility.

In *Chevron, U.S.A. v. Natural Resources Defense Council, Inc*., the U.S. Supreme Court established a doctrine requiring courts to defer to reasonable agency statutory interpretations and actions if Congress delegated authority over the relevant subject to the agency.[21] To determine whether such judicial deference is appropriate in a given case of statutory interpretation, the Court developed a two-step test, now known as Chevron review. In Chevron Step One, the court examines "whether Congress has directly spoken to the precise question at issue."[22] If the court finds that Congress has directly spoken to the precise question at issue, "that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress."[23] Only failing an affirmative response to the Chevron Step One inquiry—if the statute is "silent or ambiguous" with respect to the specific issue—would the court move to the Chevron Step Two analysis to determine whether the agency's interpretation is "based on a permissible construction of the statute."[24]

As discussed below, a court reviewing the FHFA's decision to exclude captive insurance companies from FHFA membership eligibility should end its inquiry at Chevron Step One and decline to grant deference to such an interpretation, since "Congress has directly spoken to the precise question at issue." Even if a court were to proceed to Chevron Step Two, an analysis of the FHFA's Captive Exclusion Rule should find that such a rule is contrary to the "expressed intent of Congress" and therefore not a "reasonable construction" of the statute entitled to judicial deference.

1. Chevron Deference Not Available Where the Statute is Unambiguous

Under Chevron Step One, courts must give effect to the "unambiguously expressed intent of Congress," without deference to agency positions that are contrary to such unambiguously expressed Congressional intent. In determining whether the intent of Congress has been "unambiguously expressed," courts have repeatedly looked to whether "the *text* of the statute resolves the issue" (emphasis added).[25] The primacy of the statutory text in a Chevron Step One analysis has been upheld by multiple appellate courts, which have stated that "the first step in determining the intent of Congress is to

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[21] *Chevron, U.S.A., Inc. v. NRDC*, 467 U.S. 837 (1984).

[22] *Id.* at 842.

[23] *Id.* at 842–43.

[24] *Id.* at 843.

[25] *See Yellow Transp., Inc. v. Michigan*, 537 U.S. 36, 45 (2002).

examine the language of the statute."[26] Agencies are not entitled to judicial deference for interpretations that amount to a policy decision contrary to an existing legislative determination; instead, "deference is appropriate only where 'Congress has not directly addressed the precise question at issue' *through the statutory text*" (emphasis added).[27]

In examining the language of the statute at issue, courts have also repeatedly relied on a plain meaning construction of the statute, stating that "if the language is unambiguous on its face, 'then the first canon is also the last: judicial inquiry is complete.'"[28] Accordingly, the full extent of a court's analysis in Chevron Step One involves asking "whether the statute's *plain terms* 'directly addres[s] the precise question at issue.'" (emphasis added)[29]

That the plain terms of the statutory language are dispositive to the Chevron inquiry has been further emphasized by judicial statements that "neither the legislative history nor the reasonableness of the [agency's] method would be determinative if the plain language of the statute unambiguously indicated that Congress sought to foreclose the [agency's] interpretation."[30] An agency's attempt to divine a statutory purpose "at the expense of the terms of the statute itself takes no account of the processes of compromise and, in the end, prevents the effectuation of congressional intent."[31] In addition, courts have ruled that "[a]n agency has no power to 'tailor' legislation to bureaucratic policy goals by rewriting unambiguous statutory terms.'"[32] Rather, the Supreme Court has recognized that "if the intent of Congress is clear and unambiguously expressed *by the statutory language at issue*, that would be the end" of its Chevron analysis (emphasis added).[33]

In the case of the scope of insurance companies eligible for FHLB membership, Congress has spoken clearly on the specific issue at hand by unambiguously extending FHLB membership eligibility to *any* insurance company.

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[26] *Mississippi Poultry Ass'n v. Madigan*, 992 F.2d 1359, 1363 (5th Cir. 1993).

[27] *Nat'l Ass'n of Home Builders v. Defenders of Wildlife*, 551 U.S. 644, 665 (2007).

[28] *Mississippi Poultry Ass'n v. Madigan*, 992 F.2d 1359, 1363, 1375 (5th Cir. 1993) (quoting *Rubin v. U.S.*, 449 U.S. 424, 430 (1981)).

[29] *National Cable & Telecommunications Ass'n v. Brand X Internet Services*, 545 U.S. 967, 970 (2005).

[30] *Zuni Public School District No. 89 v. Dep't of Educ.*, 550 U.S. 81, 93 (2007).

[31] *Bd. of Governors of the Fed. Reserve Sys. v. Dimension Fin. Corp.,* 474 U.S. 361, 373-374 (1986).

[32] *Util. Air Regulatory Grp. v. EPA*, 134 S. Ct. 2427, 2445 (2014). *See also National Assn. of Home Builders v. Defenders of Wildlife*, 551 U. S. 644, 665 (2007) (quoting *Chevron, U.S.A. v. NRDC*, 467 U. S. 837, 843 (1984)). *See also Board of Governors of the Federal Reserve System v. Dimension Fin. Corp.*, 474 U.S. 361-62 (1986) (stating that an administrative agency's "rulemaking power is limited to adopting regulations to carry into effect Congress' will as expressed in the statute," and holding that the Federal Reserve acted outside of its statutory authority when it adopted regulations that expanded a statutory definition beyond the will of Congress expressed in the statute).

[33] *Zuni*, 550 U.S. at 93 (2007).

There are no interstices created by the statute on this issue that require the FHFA to fill in by interpretation. The Captive Exclusion Rule would thus prevent the effectuation of congressional intent, as unambiguously expressed by the Bank Act statutory language itself. Therefore, a court likely would determine that the Captive Exclusion Rule is not entitled to deference under Chevron Step One.

2. *Chevron Deference Not Available Where Agency Interpretation Would Not be Reasonable or Consistent with Expressed Congressional Intent*

In light of the lack of ambiguity in the statutory text, an examination of other indicia of Congressional intent under Chevron Step Two should not be required for a court to reject the Captive Exclusion Rule.[34] Even when assessing legislative history for evidence of Congressional intent, however, courts have declined to override unambiguous statutory language in the absence of a "'clearly expressed legislative inten[t] ... contrary ...' to the plain language" of the statute.[35] Courts have found such a clearly expressed legislative intent to be lacking where, for example, the legislative history on the precise issue is "scant" or "sundry."[36]

In the case of the Bank Act's inclusion of any insurance company for FHLB membership eligibility, a review of the legislative history of the Bank Act and subsequent Congressional action reveals "scant" support for the FHFA's Captive Exclusion Rule while also demonstrating that the Bank Act's plain meaning inclusion of all insurance companies is consistent with the general context and purpose of the statute.

From its earliest days, the Bank Act's broad-based membership has been a highlighted feature of the statute (including its underlying policy goals). In his 1931 State of the Union address calling for a system of home-loan discount banks, President Hoover noted that such a system would "relieve pressures upon and give added strength to building and loan associations, savings banks, and deposit banks," with a key feature being that the system would "decentralize our credit structure."[37] The promotion of

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[34] *Zuni Public School District No. 89 v. Dep't of Educ.*, 550 U.S. 81, 93 (2007) ("[N]ormally neither the legislative history nor the reasonableness of the Secretary's method would be determinative if the plain language of the statute unambiguously indicated that Congress sought to foreclose the Secretary's interpretation."); *see also Darby v. Cisneros*, 509 U.S. 137, 147 (1993) ("Recourse to the legislative history of § 10(c) is unnecessary in light of the plain meaning of the statutory text.").

[35] *Toibb v. Radloff*, 501 U.S. 157, 162 (1991) (quoting *CPSC v. GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980)).

[36] *Toibb v. Radloff*, 501 U.S. 157, 162 (1991).

[37] Herbert Hoover: "Annual Message to the Congress on the State of the Union," December 8, 1931, *available at* https://www.presidency.ucsb.edu/documents/annual-message-the-congress-the-state-the-union-24.

decentralized credit was a noted feature during Congressional committee hearings for the Bank Act.[38]

To facilitate this decentralized access to credit, most significant members of the home financing field then in existence were permitted membership.[39] Members of Congress specifically discussed and declined to adopt proposals that would have restricted FHLB membership eligibility.[40] In fact, even after members of Congress were expressly alerted to the broad scope of insurance companies eligible for FHLB membership under the statutory text and asked to narrow the scope of eligible insurance companies, Congress nevertheless declined to adopt proposals that would have narrowed the scope of insurance companies eligible for FHLB membership.[41]

The fact that Congress was specifically on notice regarding the broad scope of insurance companies eligible for FHLB membership and declined to narrow the insurance company membership eligibility criteria undermines the legal authority for the FHFA, through the Captive Exclusion Rule, to override unambiguous statutory language. Contrary to the FHFA's claims that captive insurers "cannot have been within the contemplation of Congress,"[42] insurance companies formed to exclusively insure the risks of affiliated entities were in existence when the Bank Act was passed.[43] For

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[38] Creation of a System of Federal Home Loan Banks: Hearings Before a Subcomm. of the H. Comm. on Banking and Currency, 72nd Cong. 12 (1932), Statement of I. Friedlander, Chairman Advisory Committee on State Legislation of the United States Building and Loan League ("Now, naturally, this bill undertakes, as I said before, to decentralize home financing credit.")

[39] Herbert Hoover: "Statement About Signing the Federal Home Loan Bank Act", July 22, 1932. Online by Gerhard Peters and John T. Woolley, The American Presidency Project. https://www.presidency.ucsb.edu/documents/statement-about-signing-the-federal-home-loan-bank-act (stating that "[b]uilding and loan associations, savings banks, insurance companies, etc. are to be eligible for membership in the system," with the word "etc." emphasizing that numerous types of members were contemplated.).

[40] H.R. Rep. No. 72-1418, at 13 (declining to adopt a proposal to preclude "State banks, trust companies, or other banking organizations" from FHLB membership due to such entities having access to funding from other sources. Notably, the proposed membership restrictions made no mention of restricting the types of insurance companies that could obtain Bank funding.).

[41] Creation of a System of Federal Home Loan Banks: Hearings Before a Subcomm. of the H. Comm. on Banking and Currency, 72nd Cong. 12 (1932), Statement of Morton Bodfish, Executive Manager, United States Building and Loan League (proposing to limit the scope of insurance companies eligible for FHLB membership and noting to members of Congress that "insurance companies appeared in the old bill just as 'insurance companies.' I think scrutiny by the board is particularly important in the case of insurance companies, because what is· an insurance company? We have fire, life, casualty, fraternal, title, and even some matrimonial insurance companies in Chicago.").

[42] FHFA Final Rule at 3261.

[43] Shanique Hall, *Recent Developments in the Captive Insurance Industry*, CIPR Newsletter (Jan. 2012), *available at* https://www.naic.org/cipr_newsletter_archive/vol2_captive.htm (discussing "captive" programs organized as early as the 1920's). *See also Johnson & Johnson v. Director, Div. of Taxation and Com'r,* 30 N.J. Tax 479 (Tax Court of New Jersey, 2018) (noting that the "captive insurance concept has been around for a long time. In the early 1500's, ship owners met in the London coffeehouses where

example, The Church Insurance Company was incorporated in 1929 and was a wholly-owned subsidiary of The Church Pension Fund meant to provide insurance coverage to the Episcopal Church.[44] The Church Insurance Company "administered the clergy pension system of the Episcopal Church, including pension, insurance, annuities, and other programs."[45] While the nomenclature for "captive insurance companies" may have evolved since the Bank Act, there is no clearly expressed legislative intent contrary to the plain language of the Bank Act that entities underwriting insurance for affiliates are eligible for FHLB membership.[46]

Moreover, including captive insurers in the scope of eligible FHLB members in accordance with the Bank Act's plain meaning would not frustrate the object of the law or produce a result "plainly at variance with the policy of the legislation as a whole."[47] Rather, Congress has repeatedly adopted an inclusive and expansive approach to FHLB membership eligibility under the Bank Act, extending membership to commercial banks and credit unions in 1989, to insured depository institutions with assets below a set threshold in 1999, to community development financial institutions in 2008 and, more recently, to certain privately insured credit unions in 2015.[48] This

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they retained, shared and transferred the risk associated with their ships, akin to today's captives. During the 1700's and 1800's, there were instances of mutual insurance companies being formed by members of a particular industry to provide insurance coverage.")

[44] Report on Examination of The Church Insurance Company, 3,5, January 30, 2014, *available at* https://www.dfs.ny.gov/docs/insurance/exam_rpt/10669f12.pdf; ("When the Company was an active insurer, it had provided commercial multi-peril insurance coverage to parish churches, mission churches, chapels, rectories, parish houses and all other properties owned by or affiliated with the Episcopal Church, such as schools, social services, cams and conference centers.")

[45] *Id.*

[46] FHFA Final Rule at 3261.

[47] *U.S. v. Am. Trucking Ass'ns, Inc.*, 310 U.S. 534, 543 (1940); *see also United Steelworkers of Am. v. Weber*, 443 U.S. 193, 201 (1979) ("It is a 'familiar rule that a thing may be within the letter of the statute and yet not within the statute, because not within its spirit nor within the intention of its makers.'") (quoting *Holy Trinity Church v. U.S.*, 143 U.S. 457, 459 (1892)); *Am. Trucking Ass'ns, Inc.*, 310 U.S. at 543-44 ("When aid to construction of the meaning of words, as used in the statute, is available, there certainly can be no 'rule of law' which forbids its use, however clear the words may appear on 'superficial examination'."); *Helvering v. New York Trust Co.*, 292 U.S. 455, 464 (1934) ("[T]he expounding of a statutory provision strictly according to the letter without regard to other parts of the Act and legislative history would often defeat the object intended to be accomplished.")

[48] *See* Financial Institutions Reform, Recovery and Enforcement Act of 1989 ("FIRREA"), Pub. L. No. 101-73, 101 Stat. 183 (making commercial banks and credit unions eligible, for the first time, for FHLB membership with the inclusion of "any insured depository institution" in the Bank Act); *see also* Gramm-Leach-Bliley Act of 1999 ("GLBA"), (Pub.L. 106–102, 113 Stat. 1338 (exempting certain depository institutions from the FHLB membership requirement that insured depositories have at least 10% of their total assets in residential mortgage loans and authorizing such institutions to pledge as collateral certain non-mortgage assets, including small farm loans and small business loans, to support their credit obligations with FHLBs); *see also* Housing and Economic Recovery Act of 2008 ("HERA"), Public Law 110–289, 122 Stat. 2654 (2008) (expressly authorizing certified community development financial institution to become members); *see also* Fixing Americas Surface Transportation Act of 2015

inclusive and expansive approach demonstrated by such post-enactment legislative history was emphasized to the FHFA by various members of Congress in opposition to the Captive Exclusion Rule, who noted that "[O]n multiple occasions, Congress has expanded the categories of eligible membership and facilitated access to the important funding the [FHLB] provide[s]," and that Congress "did not choose to narrow eligibility for participation in its system, making its intent clear."[49] Further, multiple pieces of bipartisan legislation have been introduced that would reverse the FHFA's 2021 deadline regarding captive insurance company members that are able to evidence that their parent companies or affiliates support residential mortgage activities. These bills clearly signal that the impending deadline is contrary to Congress' intent for the FHLBs to have a broad membership pool.[50]

3. Chevron Deference Conclusion

As explained in Part II.A, Congress *has*, in fact, directly addressed the precise question at issue through the statutory text, and has unambiguously provided that FHLB membership is available to *any* insurance company, regardless of the insurance company's particular structure, products or business model. Because the Bank Act is unambiguous with respect to the scope of insurance companies eligible for FHLB membership, this assessment of the Bank Act's plain terms should be the end of a court's *Chevron* analysis. The FHFA's Captive Exclusion Rule is contrary to such unambiguously expressed Congressional intent, such that deference to the Captive Exclusion Rule would not be appropriate under Chevron Step One.

Further, even if a court were to proceed to Chevron Step Two, an analysis of the Captive Exclusion Rule should find that such an interpretation is contrary to the "expressed intent of Congress" and therefore not a "reasonable construction" of the statute entitled to judicial deference. As discussed above, a review of the legislative history of the Bank Act and its subsequent amendments reveal support for the plain meaning of the statute's inclusion of *any* insurance company and, more generally, for

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("FAST"), Public Law 114-94, 129 Stat. 1312 (permitting certain privately insured credit unions to be eligible for membership in the FHLB).

[49] Letter from Members of Congress, to the Dir. of the FHFA (November 17, 2014)*;see also* Letter from Peter J. Roskam and Rodney Davis, Members of Congress, to the Dir. of the FHFA (January 14, 2015). Rep. Rodney Davis was a sponsor of the FAST Act.

[50] *E.g.*, Housing Opportunity Mortgage Expansion Act ("HOME Act") introduced by Senators Tammy Duckworth (D-IL), Tim Scott (R-SC) and Ron Johnson (R-WI), S. 2361, 115th Cong. (2018); Senator Ron Johnson (R-WI), Congressional Record Volume 164, No. 47 (March 19, 2018) *available at* https://www.govinfo.gov/content/pkg/CREC-2018-03-19/html/CREC-2018-03-19-pt1-PgS1785-3.htm); *see also* HOME Act, H.R. 2890, 115th Congress (2017) (" A captive insurance company that was admitted to Federal Home Loan Bank membership prior to September 12, 2014, may continue its membership in its Federal Home Loan Bank, to the same extent as any other insurance company, if its Federal Home Loan Bank determines, including based on information submitted by such company, that the affiliate company it insures has a history and mission of supporting residential mortgage activities.").

broad-based FHLB membership eligibility. Accordingly, a court should not find expressed Congressional intent under Chevron Step Two sufficient to defer to the FHFA's exclusion of captive insurers that contradicts the plain meaning of the Bank Act's statutory text.

For these reasons, the Captive Exclusion Rule should not be entitled to deference under the *Chevron* standard. In promulgating the Captive Exclusion Rule, the FHFA expressly relied on its owns assumptions regarding how Congress viewed the term "insurance company," attempting to divine a statutory purpose "at the expense of the terms of the statute itself" and ultimately tailored the Bank Act to its "bureaucratic policy goals by rewriting unambiguous statutory terms."

III. Compliance with Administrative Procedures Act and Rulemaking Requirements

A. FHFA Did Not Properly Conduct a Fulsome Cost-Benefit Analysis

Presidents of both parties have directed executive agencies to evaluate the costs and benefits of new regulatory actions.[51] The primary requirement for most agencies to conduct a cost-benefit analysis when issuing rules is under Executive Order 12866, issued in 1993 by President Clinton.[52] For rules that are determined to be significant because their annual economic effect is likely to exceed $100 million, covered agencies are required to conduct a more in-depth cost-benefit analysis, including an assessment of the costs and benefits of "reasonably feasible alternatives" to the rule.[53] Executive Order 13563, issued by President Obama in January 2011, reiterated many of the general principles of regulation in Executive Order 12866, providing that covered agencies should (i) propose or adopt a regulation only upon a reasoned determination that its benefits justify its costs, (ii) tailor regulations to impose the least burden on society, and (iii) select regulatory approaches that maximize net benefits.[54]

While Executive Orders 12866 and 13563 did not on their terms apply to independent regulatory agencies, Executive Order 13579 issued by President Obama encouraged independent regulatory agencies (including the FHFA) to comply with some of the principles in Executive Order 13563 that were directed to Cabinet departments

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[51] Executive Order 12291, 46 FR 13193 (Feb. 17, 1981); Executive Order 12498, 50 FR 1036 (Jan. 4, 1985). Even before the issuance of Executive Order 12291, however, Presidents had sought to increase executive agencies' use of cost-benefit analysis. *See* Edward P. Fuchs and James Anderson, The Institutionalization of Cost-Benefit Analysis, 10 Pub. Productivity Rev. 25, 27-30 (1987) (examining efforts to implement cost-benefit analysis in Nixon, Ford, and Carter Administrations).

[52] Executive Order 12866, "Regulatory Planning and Review," 58 Fed. Reg. 51735 (Oct. 4, 1993).

[53] *See* section 3(f) of Executive Order 12866, 58 Fed. Reg. 51735 (Oct. 4, 1993).

[54] Executive Order 13563, "Improving Regulations and Regulatory Review," 76 Fed. Reg. 3821 (Jan. 21, 2011).

and independent agencies.[55] The current administration's Treasury Department has also encouraged financial regulatory agencies to perform and make available for public comment a cost-benefit analysis, and has encouraged agencies to include such cost-benefit analyses in the administrative record of the final rule.[56]

Contrary to these directives, the FHFA adopted the Captive Exclusion Rule without adequate assessment of the relative costs and benefits of the rule. The FHFA conceded that it would adopt the Captive Exclusion Rule "[r]egardless of the financial impact, which is unknown," stating simply that "any projection the [FHFA] might attempt to make regarding the exclusion of captives would be speculative."[57] Nevertheless, the FHFA alleged that captive insurer FHLB members had been formed "solely for the purpose of providing ineligible institutions access to Bank advances" and rejected alternative approaches with respect to captive insurers on the grounds that parent companies of captive insurers would have "legal and other expert resources available…that would enable them to develop methods of effectively circumventing any such restrictions."[58]

This attribution of an evasive motive to captive insurers seeking FHLB membership resulted in the FHFA's adoption of regulatory restrictions on FHLB membership that are not well-tailored to the housing and community development mission of the FHLBs. PMI, for example, serves a valuable role in the home finance market, as nearly half of its balance sheet assets (as of May 31, 2020) consist of residential mortgage loans and investments in FHLB stock. PMI's large holdings of residential mortgage loans include over $[400] million of non-qualified whole mortgage loans, which provide financing to an otherwise underserved subset of home mortgage borrowers.

Moreover, any concerns regarding evasion of the FHLB mission should be abated when considering that the collateral eligible to secure FHLB advances is already limited by law to mortgage and other assets that generally have a close nexus to the FHLBs' mission, such that broader membership eligibility should not necessarily detract from that mission. Further, FHLBs could apply—and, in fact, have applied—a more risk-tailored approach by applying higher haircuts to collateral from, or charging a higher interest rate on advances to, captive insurers, to the extent that any such captives are determined to pose relatively higher risk.

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[55] Executive Order 13579, "Regulation and Independent Regulatory Agencies," 76 Fed. Reg. 41587 (July 14, 2011).

[56] U.S. Dep't of the Treasury, A FINANCIAL SYSTEM THAT CREATES ECONOMIC OPPORTUNITIES: BANKS AND CREDIT UNIONS (2017).

[57] FHFA Final Rule at 3264.

[58] FHFA Final Rule at 3254, 3264.

The benefits of excluding captive insurers would therefore be minimal and better addressed through more narrowly tailored approaches. Notably, the FHFA confirmed that its decision to adopt the Captive Exclusion Rule was "not primarily from safety and soundness concerns regarding captive insurers."[59] Even if the FHFA were to more heavily weight safety and soundness considerations, however, PMI and other captive insurer FHLB members are currently operating in a manner that promotes the safety and soundness of the FHLB system. As discussed in Part IV below, the FHFA could readily adopt a more narrowly tailored approach by permanently grandfathering captive insurer members that are currently in good standing and that satisfy various collateral, financial, and mission-related criteria to promote safety and soundness.

The costs of the Captive Exclusion Rule, meanwhile, would include denying FHLBs an avenue to grow and diversify their membership base beyond traditional channels, and thereby to develop a more stable capital position and resilience to economic and market shocks. In addition, the Captive Exclusion Rule would deny the housing finance market a key source of stable funding for captive insurers and their affiliates that play a major role in the investment demand for mortgage-backed securities and in containing mortgage rates for borrowers.

Given the significance of the Captive Exclusion Rule's financial impact both for the FHLB system and the housing finance market more generally, the FHFA should not proceed with the exclusion of captive insurers unless and until the FHFA conducts and publishes a fulsome assessment of the relative costs and benefits of the rule, including an assessment as to whether the rule is tailored to impose the least burden on society and is designed to maximize net benefits in light of reasonably feasible alternatives.

B. FHFA Did Not Adequately Consider and Respond to Substantive Comments

In addition to not conducting a meaningful assessment of the Captive Exclusion Rule's relative costs and benefits, the FHFA did not conduct an adequate notice-and-comment rulemaking process. Specifically, despite soliciting and receiving comments over a five-year rulemaking process between the ANPR and the final Captive Exclusion Rule, the FHFA did not adequately consider a number of significant and substantive comments, contrary to judicial standards on an agency's responsibilities under the Administrative Procedure Act ("APA").[60]

Specifically, courts have stated that legitimate agency rulemaking requires that "there must be an exchange of views, information, and criticism between interested

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[59] FHFA Final Rule at 3263.

[60] 5 U.S.C. §§ 551-559.

persons and the agency."[61] The court further emphasized that "a dialogue is a two-way street: the opportunity to comment is meaningless unless the agency responds to significant points raised by the public."[62] This requirement to consider and respond to comments is designed to ensure that public participation is protected as meaningful and to guarantee that the agency is thinking through its substantive choices.[63]

An agency's response must also be coherent and substantive—a conclusory brush-off to a comment will not be enough to satisfy the duty to respond.[64] In other words, the agency needs to "respond with sufficient clarity or specificity to . . . significant challenges."[65] When an agency fails to respond to specific challenges to the proposed rule's authority, wisdom, or support, its silence is arbitrary and capricious, and thus fatal to the rule.[66]

As referenced above, the FHFA received over 400 comments in opposition to the Proposed Rule's exclusion of captive insurers (in addition to 137 comments in opposition to the FHLB eligibility changes in the ANPR). The FHFA attempted to respond to comments that had questioned its legal authority to adopt the Captive Exclusion Rule, including by reasserting its views on the intent of Congressional members in 1932 and by defending its perceived ambiguity in the statute's inclusion of "*any…insurance company*" (despite granting that "insurance company" is a "statutory term that appears on its face to have a commonly understood meaning").[67] Nevertheless, the FHFA summarily dismissed a number of other comments by claiming simply that "none of the commenters addressed FHFA's mission-related concern" and that "the volume of adverse comments does not drive FHFA's policy determinations."[68]

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[61] *Home Box Office, Inc. v. FCC*, 567 F.2d 9, 35 (D.C. Cir. 1977).

[62] *Home Box Office, Inc.*, 567 F.2d 9, 35-36 (D.C. Cir. 1977). (footnote omitted) (citing Portland Cement Ass'n v. Ruckelshaus, 486 F.2d 375, 393-94 (D.C. Cir. 1973)); *see also* Jonathan Weinberg, *The Right to Be Taken Seriously,* 67 U. MIAMI L. REV. 149, 158 (2012); Donald J. Kochan, The Commenting Power: Agency Accountability Through Public Participation, 70 OKLA. L. REV. 601 (2018).

[63] *See generally* Jonathan Weinberg, *The Right to Be Taken Seriously,* 67 U. MIAMI L. REV. 149 (2012).

[64] *Am. Mining Cong. v. EPA*, 907 F.2d 1179, 1189 (D.C. Cir. 1990) (finding agency's in-the-record responses to serious challenges to data used were insufficient because the court found "only conclusory statements that do not respond to the petitioner's challenges in any coherent manner").

[65] *Am. Mining Cong.,* 907 F.2d at 1190-91 ("We are constrained to remand to the agency for a fuller explanation . . . . Neither the summary comments nor the 1980 reports respond with sufficient clarity or specificity to the petitioners' admittedly significant challenges.").

[66] *Am. Mining Cong.,* 907 F.2d at 1191 ("[T]he agency's failure to respond to petitioners' specific challenges in the record is fatal here, since 'the points raised in the comments were sufficiently central that agency silence . . . demonstrate[s] the rulemaking to be arbitrary and capricious.'" (quoting *Nat. Res. Def. Council v. EPA*, 859 F. 2d 156, 188 (D.C. Cir. 1988)).

[67] FHFA Final Rule at 3260. The FHFA's responses to these legal authority comments were misguided for the reasons described in Part II above.

[68] FHFA Proposed Rule at 54851; FHFA Final Rule at 3254.

Such a response from the FHFA, which ignores the weight of comments that in fact addressed the FHFA's mission-related concerns, is inconsistent with its duty to engage in a substantive two-way dialogue under the APA. Specifically, as described in the ANPR, the FHFA's principal mission-related concerns with respect to captive insurers were (i) whether captive insurers are subject to the degree of supervision and examination contemplated by the Bank Act, and (ii) whether captive insurers have a *bona fide* involvement in supporting housing finance. Public commenters addressed both of these mission-related concerns for the FHFA, but were not acknowledged by the FHFA in the Proposed Rule or final adoption of the Captive Exclusion Rule.

1. FHFA Did Not Adequately Consider Significant Comments Showing that Captive Insurers are Subject to Sufficient Supervision and Examination

With respect to the FHFA's first primary concern as to whether captive insurers are subject to the degree of supervision and examination contemplated by the Bank Act, the FHFA received substantive comments from at least five state insurance regulators noting that captive insurers are subject to material inspection and regulation. The Vermont Department of Financial Regulation, which regulates PMI along with nearly 600 other captive insurance companies, noted that captive insurers are "held to similar standards as other insurance companies" and are subject to "much the same" regulation as other insurance companies, including "licensing requirements, capital and surplus standards, annual or quarterly financial reporting requirements for the captive *and parent*, annual CPA audits, regular department examinations and investment restrictions."[69] As a Vermont-licensed captive insurer, PMI is subject to inspection and examination by the Vermont Commissioner of Financial Regulation at any time that the Commissioner determines it to be prudent, and may have its license suspended or revoked based on any impairment of its capital or surplus, reporting noncompliance or operating in an unsound manner.[70]

Similarly, the Michigan Department of Insurance and Financial Services noted that "[i]n Michigan, captive insurance companies are regulated in a manner very similar to that of traditional insurance companies [and] go through a rigorous licensing process," while also being required to "have an actuary feasibility study that analyzes the reasonableness and adequacy of proposed rates and policies," "file an annual report complete with an actuarial opinion on the adequacy of the established loss reserves," and "be examined on-site."[71] Regulators for the states of Delaware and South Carolina

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[69] Comment by David F. Provost, Deputy Commissioner, Vermont Department of Financial Regulation (January 8, 2015).

[70] 8 V.S.A. §§ 6008; 6009

[71] Comment of David Piner, Michigan Department of Insurance and Financial Services (January 5, 2015).

similarly noted the financial reporting requirements and "robust financial regulation" to which captive insurers are subject.[72]

As these comments demonstrate, captive insurers are subject to supervisory regimes of prudential regulation at least equivalent to those applicable to other eligible members. Despite these reassurances by authoritative sources, though, the FHFA made no mention of the comments received from state insurance regulators in adopting the Captive Exclusion Rule. Instead, the FHFA shifted the focus of its concern, suggesting that even thorough inspection and regulation by a home-state regulator may not be sufficient if captive insurers are "'licensed in only one state, and operat[e] under the captive insurance law of that domicile.'"[73] However, the Bank Act requires only that an eligible FHLB member be "subject to inspection and regulation," which the FHFA itself has confirmed requires only inspection and regulation by "*an* appropriate State regulator accredited by the NAIC."[74] Nowhere does the Bank Act require an insurance company or any other eligible FHLB member to be subject to inspection and regulation on a multi-state basis. Thus, the FHFA lacks a basis for curtailing the FHLB membership eligibility of captive insurers in light of the Bank Act's inspection-and-regulation requirement.

2. *FHFA Did Not Fully Account for Significant Comments Showing that Captive Insurers Have a Bona Fide Involvement in Housing Finance*

With respect to the FHFA's second primary concern as to whether captive insurers have a *bona fide* involvement in supporting housing finance or are rather mere conduits to provide advances to affiliated companies, comments by state insurance regulators repeatedly assured the FHFA that captive insurance companies do not exist as mere conduit entities and cannot simply be raided by a parent entity or other affiliate. For example, and of particular note with respect to PMI, the Vermont Department of Financial Regulation noted that its state regulation regarding approval of dividends is "actually more restrictive" than the regulation application to other insurance companies.[75] Under Vermont law, PMI is prohibited from paying any dividend out of, or other distribution with respect to, capital or surplus without the prior approval of the Vermont Commissioner of Financial Regulation, and any approval of an ongoing dividend plan must be conditioned on the retention of a specified amount of capital or surplus at the time of each dividend payment.[76] Accordingly, applicable law precludes

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[72] *See* Comment of Steve Kinion, Delaware Department of Insurance (January 12, 2015); *see also* Comment of Raymond G. Farmer, South Carolina Department of Insurance (October 31, 2014).

[73] FHFA Final Rule at 3256.

[74] 12 U.S.C. § 1424(a)(1)(B); 12 C.F.R. §§ 1263.8; 1263.1 (emphasis added).

[75] Comment by David F. Provost, Deputy Commissioner, Vermont Department of Financial Regulation (January 8, 2015).

[76] 8 V.S.A. § 6005.

PMI from being used as merely a shell funding conduit for its parent or affiliated companies.

Similarly, the Delaware Department of Insurance noted that "Delaware law requires that any material withdrawal of cash or other assets from a captive insurer must receive prior regulatory approval," and that the supervisory staff would not approve any distributions that would jeopardize a captive insurer's financial health.[77]

Further, commenters noted that real estate investment trusts with captive insurer affiliates are limited by law to investing primarily in real estate or real estate loans, and support the FHFA's mission by financing the origination and acquisition of mission-centric assets like residential mortgages and affordable housing bonds, acting as a key liquidity channel for the housing finance system and reinvesting FHLB advances into the housing finance market.[78] In addition, commenters noted that FHLB collateral eligibility requirements generally require residential and multi-family commercial whole loans, agency and non-agency residential mortgage-backed securities and commercial mortgage-backed securities to be pledged to secure FHLB advances, providing a natural safeguard in against FHLB members obtaining advances in contravention of the FHFA's mission.[79] Still others described the importance of captive insurer affiliates to the overall U.S. housing finance market.[80]

In adopting the Captive Exclusion Rule, however, the FHFA did not squarely address such comments and adhered instead to its generalized concept of all captive insurers being improperly motivated to serve as evasive conduits. For example, the FHFA made no mention of state law restrictions on distributions by captive insurers to affiliates. The FHFA alluded to commenters' arguments regarding the self-regulating effect of collateral eligibility requirements only in passing, claiming that FHLB

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[77] Comment of Steve Kinion, Delaware Department of Insurance (January 12, 2015).

[78] Comment by David H. Stevens, Mortgage Bankers Association (January 9, 2015). *See also* Comment by Stanford L. Kurland, PennyMac Mortgage Investment Trust (January 9, 2015) (describing how PennyMac's business model fits squarely within the scope of the activities that the Bank Act was intended to support, including by acquiring and holding whole mortgage loans and distressed home loans that are held for investment).

[79] 12 C.F.R. § 1266.7. *See* Comment by Sean Reid, Old Georgetown Insurance Co., LLC (January 9, 2015); *see also* Comment by Kevin E. Grant, CYS Insurance Services, LLC (December 29, 2014) ("If there was truly an issue relating to 'mission creep' whereby FHLB funds are used for non-mission specific purposes, then any potential harm would be mitigated by the self-defeating nature of the system through which the FHLBs provide advances to members. That is, if FHLB funds are increasingly used for non-mission-specific activities, then eventually the member organization will run out of eligible collateral to pledge."); Comment by LANCE Indemnity Company LLC (January 10, 2015); Comment by Meadowlark Insurance Company (January 9, 2015).

[80] *See, e.g.*, Comment by Kevin E. Grant, CYS Insurance Services, LLC (December 29, 2014); Comment by David H. Stevens, Mortgage Bankers Association (January 9, 2015); Comment by NYMT Insurance Holdings, LLC (January 6, 2015).

"advances need not be collateralized with residential mortgage assets."[81] Yet this response by the FHFA did not completely address the argument advanced by commenters, as the non-mortgage related assets that the FHFA listed as examples of eligible collateral (*i.e.*, small business, agriculture, or community development loans) are eligible only for advances to community financial institutions (with FDIC-insured deposits) and thus inapplicable to captive insurers.[82] Thus, the FHFA lacks a basis for deeming captive insurers ineligible conduits with inadequate ties to housing finance.

IV. Alternative Grandfather for Captive Insurance Companies in Good Standing

Rather than implementing a blanket exclusion from FHLB membership for all captive insurers, the FHFA should implement a grandfather clause for current captive insurer members in good standing. To ensure that grandfathered captive insurance company members remain consistent with the Bank Act's eligibility standards and to address the FHFA's primary concerns set forth in its adoption of the Captive Exclusion Rule regarding whether captive insurers are subject to the degree of supervision and examination contemplated by the Bank Act and whether captive insurers have a *bona fide* involvement in supporting housing finance, the FHFA could adopt certain criteria that current captive insurer members would be required to satisfy in order to benefit from such grandfathered membership. Such criteria could relate to the captive insurer's commitment to the FHFA's home finance mission and/or the captive insurer's ability to operate in a manner that promotes the safety and soundness of the FHLB system. Examples of such possible criteria for grandfathered captive insurers include:

- *Ongoing Compliance with "40% Assets Test"*: The Captive Exclusion Rule permitted any captive insurer that had been admitted to FHLB membership prior to the Proposed Rule to remain a FHLB member for five years following the final Captive Exclusion Rule, provided that the amount of FHLB advances outstanding to such a captive insurer member would be capped at 40% of the captive insurer's total assets (the "40% Assets Test"). The FHFA could extend this criteria to permit any captive insurer that had been admitted to FHLB membership prior to the final Captive Exclusion Rule to remain a FHLB member indefinitely, provided that the amount of FHLB advances outstanding to such a grandfathered captive insurer member comply with the 40% Assets Test.

- *Asset Pledging Requirement*: The FHFA could require that an FHLB take possession of any assets pledged by a grandfathered captive insurer member to secure FHLB advances, while precluding advances secured by "blanket" liens or affiliate pledges. In addition, in order to alleviate any perceived risk

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[81] FHFA Final Rule at 3258.

[82] FHFA Final Rule at 3246; *see also* 12 C.F.R. §§ 1266.7(b); 1266.1; 1263.1.

about the FHLBs' ability to perfect security interests in collateral pledged by grandfathered captive insurance members, the FHFA could require heightened requirements for captive insurance company collateral as it does for the collateral of other non-depository FHLB members.

- *Financial Covenants Requirement*: The FHFA could require that each grandfathered captive insurer member comply with various financial covenants that would be tailored to the specific financial condition of each captive insurer. For example, the FHFA could require that certain grandfathered captive insurers (i) maintain sufficient liquidity in respect of FHLB borrowings (*e.g.*, by requiring captive insurers to maintain liquid assets of at least 2% of outstanding FHLB advances and letters of credit); (ii) maintain sufficient unencumbered assets in respect of FHLB borrowings (*e.g.*, by requiring captive insurers to maintain unencumbered assets of at least 20% of drawn FHLB advances); (iii) maintain sufficient equity capital (*e.g.*, by requiring captive insurers to maintain a ratio of total equity to total assets of at least 20%, which is nearly double the equity-to-assets ratio of the top 10 largest U.S. bank holding companies); (iv) provide a negative pledge to the applicable FHLB with respect to the captive insurer's other assets.

- *Full Recourse Parent Guaranty*: While FHLBs would continue to underwrite advances to grandfathered captive insurers on the basis of the captive insurer's independent financial condition, the FHFA could require that any outstanding FHLB advances to a grandfathered captive insurer be supported by a full guarantee of the captive insurer's parent company.

- *Mission Orientation Requirement*: The FHFA could require that borrowings by a grandfathered captive insurer be secured by assets that clearly and distinctly align the captive insurer with the FHLBs' mission to support housing finance and community investment (*e.g.*, by limiting eligible collateral for grandfathered captive insurers to residential whole loans and multi-family whole loans).

Permitting captive insurers that are currently FHLB members in good standing, and that comply with criteria such as those described above, to remain FHLB members would ensure that captive insurance companies members remain among the lowest risk borrowers in the FHLB system.

As an FHLB member since 2010, PMI has served a successful example of a captive insurer member satisfying a number of the criteria described above and thereby supporting the safety and soundness of the FHLB system. For example, PMI's equity to asset ratio is significantly higher than that of each of the top ten largest U.S. bank holding companies (by total asset size), and is significantly higher than that of all but one of the top ten largest U.S. non-captive insurance companies (by total asset size). Additional detail is provided in Attachment A. PMI's residential mortgage loan collateral for FHLB borrowings demonstrates strong credit characteristics, such as an

average loan-to-value ratio ("LTV") of approximately 68%, a pass-through LTV (collateral LTV multiplied by the FHLB advance rate) of approximately 48% and an average credit score of over 730. As noted above, PMI is strongly capitalized, with a regulatory capital surplus of almost $1 billion (as of May 31, 2020). The borrowers for which PMI provides credit access are often self-employed borrowers that fall outside of the criteria for Fannie Mae, Freddie Mac, or Ginnie Mae subsidized financing, but are nonetheless highly deserving of mortgage credit and fit squarely in the FHLB mission of reliable liquidity to member institutions to support housing finance, particularly to the underserved and underbanked.

PMI's continued membership through a permanent grandfathering rule, therefore, does not pose safety and soundness concerns to the FHLB system. To the contrary, permitting PMI's continued membership supports a diversity of membership, a more stable capital position for the and increased resiliency to economic and market shocks, as well as the housing and community development mission of the FHLBs.

V. Conclusion

For the reasons noted above, the FHFA lacks adequate legal authority to unilaterally, through the Captive Exclusion Rule, terminate FHLB membership eligibility for a class of current members in good standing and with clear eligibility under the Bank Act. The plain meaning reading of the Bank Act provides that FHLB membership eligibility is available to "*any…insurance company,*" including any captive insurance company. The FHFA's interpretation to the contrary under the Captive Exclusion Rule is not supported by the language of the statute, the Bank Act's legislative history, or the underlying purpose of the Bank Act or FHLB system. Further, if the FHFA were to give effect to the Captive Exclusion Rule even following the rule's five-year transition period, a court should reasonably invalidate the rule under a *Chevron* analysis or, alternatively, under an APA assessment of the shortcomings in the FHFA's rulemaking process.

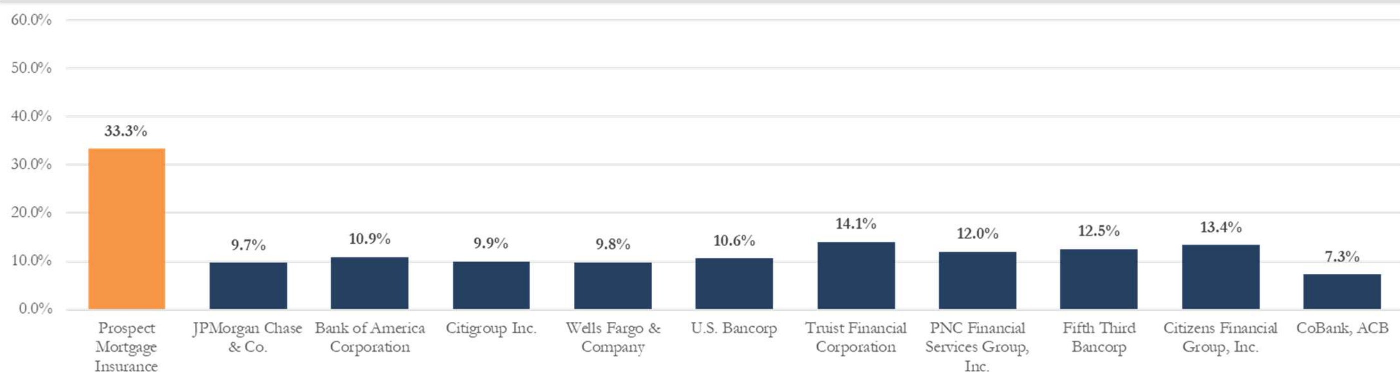
The FHFA should therefore repeal the Captive Exclusion Rule and restore FHLB membership eligibility to captive insurers or, in the alternative, permanently grandfather captive insurance companies that are currently FHLB members in good standing.

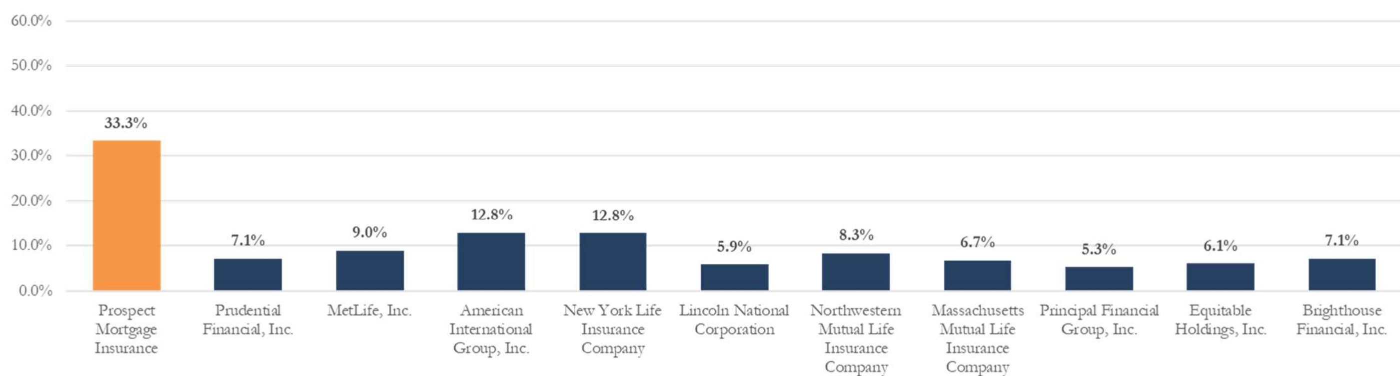
Very truly yours,

Keith Noreika

cc: Andrew Sossen, Esq.
Steven Ujvary
Starwood Property Trust, Inc.

Attachment A
Equity-to-Asset Ratios
PMI vs. Top-Ten Banks and Insurance Companies





Source: S&P Global Market Intelligence

Screener Criteria: (i) Geography in United States, (ii) Company Status in Operating, Industry Classification in (Bank or Insurance), and (iv) Top 10 Rank by Total Assets (FY 2019)

Calculation: FY 2019 Total Equity divided by FY2019 Total Assets