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National Association of Federally-Insured Credit Unions

October 21, 2022

Clinton Jones
General Counsel
Federal Housing Finance Agency
400 7th Street SW
Washington, DC 20219

RE: FHLBank System at 100: Focusing on the Future

Dear Mr. Jones:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), I am writing in response to the Federal Housing Finance Agency's (FHFA) comprehensive review of the Federal Home Loan Bank (FHLB) System as it approaches its centennial. NAFCU advocates for all federally-insured not-for-profit credit unions that, in turn, serve 133 million consumers with personal and small business financial services products. NAFCU appreciates the FHFA for reviewing the FHLB System (System) to ensure it remains positioned to meet the needs of today and tomorrow. Overall, NAFCU urges the FHFA to do no harm to the System as a result of this review. Should the FHFA be considering expansion of membership to the System, NAFCU recommends that it be limited to those entities that are subject to capital requirements and a regulatory scheme from a prudential regulator. NAFCU further urges the FHFA to waive the prohibition in its tangible capital rule in the short term and align its tangible capital rule with the capital definition of federal financial regulators in the longer term. Finally, NAFCU welcomes the support of the FHFA in the effort to correct the exclusion of credit unions from the statutory definition of community financial institutions (CFIs).

General Comments

Many of NAFCU's member credit unions rely on the FHLBs for liquidity purposes to fully serve their membership's mortgage and community development needs. As of the end of 2022's second quarter, the System had 1,574 credit union members, an increase of more than 30 percent over the past 10 years.[1] Credit unions now account for nearly 25 percent of the System's total membership base.[2] Just a decade ago credit unions accounted for only about 15 percent of the System's total membership.[3] Over their 90-year history, the FHLBs have provided critical liquidity to credit

[1] "Combined Financial Report for the Quarterly Period Ended June 30, 2022" Federal Home Loan Banks (August 12, 2022) https://www.fhlb-of.com/ofweb_userWeb/resources/2022Q2CFR.pdf.
[2] "Combined Financial Report for the Quarterly Period Ended June 30, 2022" Federal Home Loan Banks (August 12, 2022) https://www.fhlb-of.com/ofweb_userWeb/resources/2022Q2CFR.pdf.
[3] "Combined Financial Report for the Quarterly Period Ended March 31, 2013" Federal Home Loan Banks (May 14, 2013) https://www.fhlb-of.com/ofweb_userWeb/resources/13Q1end.pdf.

unions, including many smaller community lenders that often do not have access to other sources of low-cost funding, especially in stressed market environments.

NAFCU asks the FHFA to ensure that it does no harm to the System as a result of this review

Access to low-cost funding provided by the FHLBs helps the System's credit union members make a better return on deposits, allowing them to meet the credit and community development needs of the communities they serve. The cooperative nature and regional structure of the FHLBs enables each FHLB to respond to local needs, and design products and services tailored to the communities served by their credit union members.

FHLBs operate without taxpayer dollars. Additionally, no FHLB has ever taken a credit loss on a loan to a member, credit union or otherwise. The FHLB System remains relevant, provides value to its credit union members, and enhances stability in the financial system. For the FHFA's review process to be successful, it is critical that: the regional nature of the System be maintained to continue to effectively serve its credit union members; current credit union members continue to have access to the FHLBs; and any changes to membership or structure enhance the value and importance of the FHLBs to their credit union members and the communities they serve.

Maintaining a strong System is important for NAFCU and its members as the liquidity that the FHLBs provide is critical to credit unions. For example, credit unions utilize the FHLBs' Affordable Housing Programs (AHP) to assist in community development and providing access to credit for minority and low- and moderate-income borrowers. Any policy changes, such as altering the valuation of collateral used for FHLB advances or a reduction in liquidity or funding options for the AHP, would have a substantial impact on credit unions ability to serve their members. This example highlights just how impactful changes to the System can be on the credit union industry, underscoring that any policy adjustments should consider a holistic perspective and should only be adopted after notice and comment rulemaking to ensure a transparent process and opportunity for stakeholder feedback.

Expanding Membership

Currently, the vast majority of FHLB members are depository financial institutions subject to safety and soundness examinations, which provides the System with a significant degree of safety. Regulators' examination reports provide the FHLBs with information on the financial condition of members on an ongoing basis, signaling changes to a member's risk assessment. In order to maintain reasonable risk in the System and preserve its benefits for current members, the most important financial factor must be the presence of capital requirements from a prudential regulator.

Credit unions are subject to a significant supervisory regime by the National Credit Union Administration (NCUA), which includes capital requirements and regular examination for safety and soundness. Banks are also subject to similar requirements by their prudential regulators. Most non-depository financial institutions are not regulated by a prudential federal regulator and are only subject to regulation by state supervisory authorities, which may vary state by state and may not include capital and liquidity standards. For these reasons, any expansion of membership to the FHLB System should exclude non-depository institutions such as fintechs.

NAFCU continuously advocates for a regulatory environment that promotes competition and responsible innovation; however, the risk of regulatory arbitrage remains a concern as fintech companies continue to operate on the periphery of traditional supervisory domains. Because many fintechs exist outside the purview of a prudential regulator, they are not competing on a level playing field and therefore pose serious systemic risks to financial markets. For credit unions, these risks are troubling and have a real-world impact because traditional financial institutions must deal with the fallout from the harm of an insufficient regulatory framework for fintechs. NAFCU has urged the FHFA to increase the capital requirements for non-depository institutions who aren't subject to oversight by a prudential federal regulator in order to protect the safety and soundness of the housing finance system.[4] Additionally, NAFCU has urged the Consumer Financial Protection Bureau to do more to supervise these underregulated market players, including exercising its "larger participant" authority.[5] Fintechs should have a prudential federal regulator in order to mitigate risks to the financial market, especially the housing finance system; unless and until they do, they should not be afforded membership in the System.

Tangible Capital

FHFA regulations state that the FHLBs cannot make a new advance to a member with negative tangible capital unless the member's appropriate prudential regulator or insurer requests in writing that the FHLB make such an advance.[6] The FHFA's regulations define tangible capital as capital, calculated according to the general accepted accounting principles (GAAP), less intangible assets.[7] Prudential regulators, including the NCUA, use regulatory accounting principles to calculate capital. The differences in the calculation of capital is causing a regulatory conflict that could, in turn, cause liquidity issues at credit unions due to the rise in interest rates. Specifically, higher interest rates are causing some financial institutions to report mark-to-market adjustments on their portfolio investments, resulting in unrealized losses because there is no plan to sell those securities.[8]

It has not yet been necessary for a credit union to obtain a request from the NCUA to continue receiving advances from the FHLBs, but it is becoming of increasing concern in these

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[4] NAFCU. Re-Proposal to Enhance Eligibility Requirements for Enterprise Single-Family Seller/Servicers (April 22, 2022) https://www.nafcu.org/system/files/files/4.22.2022%20Letter%20to%20FHFA%20re%20GSE%20Seller%20Servicers%20Eligibility%20Requirements.pdf
[5] NAFCU. Request for Comment Regarding Procedural Rule on Supervisory Authority Over Certain Nonbank Covered Persons Based on Risk Determination (May 31, 2022) https://www.nafcu.org/system/files/files/5.31.22%20Letter%20to%20CFPB%20re%20Supervisory%20Authority%20Over%20Certain%20Nonbank%20Covered%20Persons%20Based%20on%20Risk%20Determination.pdf
[6] 12 CFR 1266.4(b) https://www.ecfr.gov/current/title-12/chapter-XII/subchapter-D/part-1266#p-1266.4(b).
[7] 12 CFR 1266.1 https://www.ecfr.gov/current/title-12/chapter-XII/subchapter-D/part-1266.
[8] Kate Berry. "Rising interest rates put community banks in regulatory bind with FHFA rule," American Banker, (October 12, 2022) https://www.americanbanker.com/news/rising-interest-rates-put-community-banks-in-regulatory-bind-with-fhfa-rule

economically difficult times. As a temporary solution, NAFCU urges the FHFA to waive the prohibition in its tangible capital rule to allow credit unions to continue accessing liquidity and prevent long term effects. In the long term, NAFCU urges the FHFA to align its tangible capital rule with the capital definition of federal financial regulators.

Community Financial Institution Definition

Under the FHLB Act, the definition of a CFI only includes members whose deposits are insured under the Federal Deposit Insurance Act;[9] this definition excludes credit unions because they are insured by the NCUA under the Federal Credit Union Act, not the Federal Deposit Insurance Act. Structurally, credit unions are bound to a mandate to serve their communities because they are not-for-profit, member-owned financial cooperatives and are only allowed to serve their defined fields of membership. Due to this unique structure and the significant legal limitations placed on credit unions to ensure this mission is adhered to, all credit unions are inherently CFIs.

According to the most recent data from the NCUA, there are 4,524 credit unions with assets under $1.323 billion.[10] Of these, 2,036 credit unions have less than 10 percent of their total assets in mortgage loans and cannot currently qualify for membership without the use of the exception for CFIs. Including credit unions in the definition of CFI would allow more credit unions to make use of the exception to the membership requirement to have 10 percent of total assets in residential mortgages.

Further, under the FHLB Act, a CFI can pledge small business, small farm, small agri-business, and community development loans to an FHLB as expanded options of collateral for advances. Including credit unions in the definition of CFI would provide greater lending capacity for several credit unions and safely increase demand for advances. It would also increase FHLB membership among safe and sound organizations that share the FHLBs' mission of community development. NAFCU has urged Congress to expand the CFI definition in the FHLB Act to include credit unions and would welcome the support of the FHFA in this effort to correct the exclusion of credit unions from this statutory definition. The NAFCU-backed Member Business Loan Expansion Act, H.R. 5189, that would help credit unions better serve small businesses and amend the definition of CFI under the FHLB Act, was introduced last year as bipartisan legislation.[11] This change will ensure that the benefits of the FHLB System are fairly and appropriately extended to as many members as possible.

Conclusion

NAFCU and its members appreciate the opportunity to comment on the FHFA's comprehensive review of the System. Overall, NAFCU urges the FHFA to do no harm to the System as a result

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[9] 12 U.S.C. § 1422 https://www.govinfo.gov/content/pkg/USCODE-2020-title12/pdf/USCODE-2020-title12-chap11.pdf.
[10] NCUA Call Report Quarterly Data. https://www.ncua.gov/analysis/credit-union-corporate-call-report-data/quarterly-data
[11] Member Business Loan Expansion Act, H.R.5189, 117th Cong. (2021), https://www.congress.gov/117/bills/hr5189/BILLS-117hr5189ih.pdf

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Sincerely,

Aminah M. Moore
Senior Regulatory Affairs Counsel