MORTGAGE BANKERS ASSOCIATION

October 31, 2022

The Honorable Sandra Thompson
Director
Federal Housing Finance Agency
400 7th Street, SW
Washington, DC 20219

RE: FHLBank System at 100: Focusing on the Future – Request for Input

Dear Director Thompson:

The Mortgage Bankers Association (MBA)[1] appreciates the opportunity to provide observations and recommendations on the current and future state of the Federal Home Loan Bank (FHLB) system as the Federal Housing Finance Agency (FHFA) undertakes a comprehensive review of the FHLBs as they approach their centennial. The current housing finance system has evolved extensively over the last 90 years, and MBA agrees that the current FHLB system should be evaluated, particularly with respect to FHLB membership and eligible collateral standards.

MBA has long supported the responsible expansion of FHLB membership eligibility to better reflect today's diverse providers of single-family and multifamily housing finance and community investment activities throughout the country. U.S. mortgage debt today is predominantly held in securitized form by global investors, not as whole loans on bank and thrift balance sheets. A FHLB System, suited to today's market, would strengthen the broader finance system by increasing the supply of reliable, longer-term liquidity to the institutions and the mortgage-related assets that play critical roles in this system. Any changes to the system should be undertaken in a manner that promotes safety and soundness through appropriate risk management practices and counterparty oversight.

[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, DC, the association works to ensure the continued strength of the nation's residential and commercial real estate markets, to expand homeownership, and to extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,100 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, credit unions, thrifts, REITs, Wall Street conduits, life insurance companies, and others in the mortgage lending field. For additional information, visit MBA's website: www.mba.org.

I. Benefits of More Diverse FHLB Membership

One of the primary strengths of the U.S. housing finance system is the diverse nature of its holders of mortgage debt, lenders, and servicers. These functions are performed by depository and non-depository institutions of vastly differing sizes and business models, as well as both domestic and foreign investors. This diversity generates stronger market competition and produces tangible benefits for consumers in the form of reliable credit access, greater choice, lower pricing, and more favorable loan terms.

The set of institutions currently eligible for direct FHLB membership only partially represents this diversity. The FHLB Act, as amended, provides membership eligibility for banks, credit unions, insurance companies, and community development financial institutions, among others.[2] This structure falls far short of reflecting the full scope of institutions that today play major roles as lenders, servicers, and investors. The FHLBs today serve a shrinking set of eligible member institutions that originate and service less than half of all single-family and multifamily mortgages and hold about 52% of all single-family and multifamily mortgage debt and mortgage-backed securities (MBS) outstanding.

A more diverse FHLB membership base would enhance many of the consumer benefits noted above. The FHLBs could leverage their roles as providers of liquidity to strengthen the single-family and multifamily housing finance and community investment activities of a broader set of institutions, expanding access to credit on affordable terms for borrowers.

A broader membership base would allow the System to better achieve its mission to stabilize the housing finance market and promote investment in local needs, including affordable ownership and rental housing. The share of residential mortgage originations by FHLB-eligible institutions has declined over the past decade, thereby reducing the role of the FHLBs in providing liquidity relative to the size of the market. A responsible expansion of membership eligibility to other non-depository institutions could reverse this trend, making the FHLBs more effective providers of liquidity across the market.

Increased diversity in eligible members also would carry benefits for the individual banks. New classes of members would increase demand for advances and other FHLB offerings, thereby increasing FHLB earnings while also reducing concentration in advances to any particular type of institution. While there is a debate about what proportion of the Banks' earnings should be dedicated to their Affordable Housing Programs, the best way to grow AHP funding is to grow earnings.

Much as diversity in market participants bolsters stability for the housing finance system in the aggregate, such diversity would have a similar effect on the stability and mission of the FHLB System.

[2] 12 U.S.C. §1424(a)(1).

II. Expansion of Membership to Key Players: IMBs and REITs

Independent Mortgage Banks (IMBs) and Real Estate Investment Trusts (REITs) are two of the most notable real estate finance providers not supported by the System. Both mortgage REITs and IMBs primarily engage in housing finance activities and maintain robust financial, operational, and risk management practices.

A. IMBs, FHLB Membership, and Eligible Collateral

IMBs are critical players in the housing finance system, currently originating more than 60% of single-family loans throughout the country and, depending on the year, approximately half of multifamily lending by dollar volume. Because they do not have deposit bases that are akin to those of banks or credit unions, IMBs instead rely on warehouse lines from other institutions (typically banks) to fund the mortgages they originate until those loans are sold into the secondary market – typically within a few days to a few weeks. IMBs have also become major servicers of single-family mortgages, servicing about two-thirds of all agency-related single family mortgage debt. Offering optional FHLB membership to IMBs could strengthen housing finance market resiliency and expand the reach of the FHLBs' mission-related activities.

Access to FHLB advances would not be a primary source of funding for IMBs in the ordinary course of business, but rather an alternative source that would be available for specific situations or in periods of severe market stress.

Perhaps the most critical area where FHLB membership for IMBs could strengthen the housing finance system and improve resiliency is in the financing of servicing advances. As the housing system has evolved, securitization has become the predominant method for investors to hold mortgage assets. In order for investors to receive the cashflows from the loans in these securities, servicers must advance the monthly principal and interest payments in a timely manner, even when borrowers do not pay. For GSE and Ginnie Mae servicers, these advancing requirements are necessary to fulfill the government guarantee of those loans and can become quite burdensome for IMB servicers during times of market stress. Private financing for advances is typically available under normal market conditions, but during exigent circumstances such as the COVID-19 pandemic, which forced many borrowers across the nation to use government prescribed long-term forbearance, the FHLBs could be a valuable, stable, long-term source of liquidity. As we have noted previously, expanding the FHLB system to support IMBs in these situations would require an expansion of eligible collateral for FHLB advances.

IMBs could also be permitted to participate and sell loans directly to the FHLBs through their Mortgage Partnership Finance (MPF) program and Mortgage Purchase Program (MPP). The additional volume of loan originations IMBs could provide to the Banks' MPF and MPP programs would create a deeper, more liquid market for these loans, benefiting both the FHLBs and current participants in the programs and further promoting affordable housing for consumers.

B. IMBs and the Mission

As the largest segment of single-family mortgage originators and a significant source of lending for multifamily housing, IMBs are uniquely aligned with the mission of the FHLBs. They are typically monoline companies that focus their business on housing finance, which in many cases includes mortgage servicing as well as origination activity. IMBs' historic and current contributions to the mortgage market reinforce their importance in promoting homeownership throughout the country.

IMBs are the predominant lenders of government-insured or -guaranteed loans – markets where IMBs stepped in to fill voids that were left in the wake of the Great Recession. As a result, IMBs serve a disproportionate share of first-time homebuyers, low- to moderate-income families, and communities of color. Their business model allows global investment capital to be channeled into local housing markets, promoting access to credit at affordable costs to borrowers.

C. IMBs and Regulatory Oversight

IMBs that are seller/servicers to the GSEs or Ginnie Mae issuers are subject to counterparty reviews for compliance with recently strengthened capital, liquidity, and net worth requirements set by Ginnie Mae or by FHFA with respect to Fannie Mae or Freddie Mac counterparties. Given that FHFA already sets such requirements for IMBs that conduct business with Fannie Mae and Freddie Mac, these requirements would be an appropriate starting point for FHLB counterparty standards.

State regulators impose capital, liquidity, and net worth requirements on IMBs, which mirror the prudential standards promulgated by FHFA and Ginnie Mae. These state regulators also conduct regular onsite supervisory examinations – including multistate exams -- that address prudential, consumer protection, and governance matters. They prepare written supervisory reports and share supervisory information with other state and federal regulators based on negotiated memorandums of understanding (MOU) between involved parties.

D. REITS and Membership

Mortgage REITs, by the very nature of their business model and tax structure, provide important capital to support single-family and multifamily housing, as well as commercial community development properties, throughout the country. To qualify for REIT status, mortgage REITs must both derive the vast majority of their income from real estate-related assets and distribute a similar majority of their taxable income to their shareholders, with federal taxes paid on those dividends rather than at the corporate level. By fulfilling this dual mandate annually, and through other requirements, mortgage REITs hold assets that are almost exclusively real estate finance-related in nature. At the end of 2021, REITs held more $445 billion in single-family and multifamily mortgage debt and MBS.

Home Loan Bank advances to mortgage REITs would provide liquidity for REIT mortgage portfolios to support stable funding for increased lending to a broader group of creditworthy homeowners than those served by the conventional mortgage market today. The private wholesale funding market has been less suited to supporting loans made to borrowers who fall just outside of the product and underwriting parameters defined by the Qualified Mortgage standard, and mortgage REITs have the ability to step in and fill that void. More broadly, as FHFA and Congress work to better define the long-term activities and market footprint of Fannie Mae and Freddie Mac, mortgage REITs can use the FHLB advances to channel capital into a range of high-quality, non-agency housing finance assets currently underserved by private funding markets.

Based on their business activities, assets, and sources of income, most mortgage and hybrid REITs would almost certainly meet any tests established by FHFA or the individual Banks to ensure alignment with the FHLBs' mission. Their existence centers on housing finance and community investment in ways that make them dedicated participants in the mortgage market.

Mortgage REITs would be subject to the existing safeguards that are built into the FHLB System. Mortgage REITs would be required to purchase FHLB stock and pledge (or have their parents or affiliates pledge) acceptable collateral on which haircuts are applied, as determined by each FHLB. A mortgage REIT seeking membership would also need to provide evidence that its capital and/or liquidity positions meet minimum thresholds set by FHFA via public ratings or any other enhanced standards individual Banks may apply.

Mortgage REITs that are publicly listed also must adhere to specific guidelines and requirements for financial disclosures as implemented by the SEC. These disclosures include quarterly and annual financial reporting and could include additional reporting as determined necessary by the FHFA or a particular FHLB.

III. Expanding Membership While Maintaining Safety and Soundness

MBA acknowledges that expanding FHLB membership may require adjustments in the current methods of evaluating safety and soundness, and new authorities to monitor it. The FHLBs have a remarkable track record of success, having never incurred a loss on an advance in their nearly 90-year history.[3] The Council of Federal Home Loan Banks attributes this stability to several factors, including conservative underwriting standards and investment practices, strong credit monitoring policies, the collateralization of advances, acceptance of high-quality collateral, activity-based stock purchase requirements that are commensurate with borrowing levels, and the joint and several liability for aggregate obligations in the System.[4]

MBA believes enhancements to the existing safety and soundness requirements, and collateral standards, can be developed in a manner that strikes an appropriate balance that allows for responsible modernization of the FHLB system. With respect to counterparty oversight of new members such as IMBs and REITs, we suggest consideration of the following options:

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[3] Council of Federal Home Loan Banks, "Safety and Soundness." Available at: https://fhlbanks.com/safety-and-soundness/.
[4] Ibid.

A. **Leverage access to existing safety and soundness and consumer compliance examinations conducted by state regulators.** As noted previously, prudential and consumer oversight of IMBs by the states has become substantially more rigorous since the financial crisis. This would mirror the approach currently in place for state regulated insurance companies. To protect confidential supervisory information, MOUs would be needed between the FHFA, the FHLBs, and the state regulators, coordinated by the Conference of State Bank Supervisors (CSBS). CSBS currently has such an MOU with the CFPB.
B. **Leverage counterparty oversight of IMBs and REITs by the GSEs and Ginnie Mae.** As with state regulators, this would require an MOU between the parties to cover the appropriate scope of information sharing and the requisite confidentiality and privilege protections for confidential supervisory information.
C. **Establish limited, direct federal oversight of IMB/REIT members by FHFA.** Since FHLB membership would be optional, IMBs and REITs that join the System would opt-in to a federal supervision and oversight regime by the FHFA. Supervisory powers could be exercised by the FHFA or delegated to the Banks. This would provide FHFA direct examination and supervisory authority over these institutions. Such authority would be properly scoped to focus on the risks posed by the new member to the FHLBs, and to limit regulatory burden.

A new safety and soundness framework for IMB and REIT members of the FHLB system should be carefully constructed to balance any new burdens with the benefits of joining the system. Excessive costs will subvert the stability and mission benefits of modernization.

As noted in the previous section, today's securitization-based mortgage market has created new types of assets that warrant consideration as eligible collateral – most notably mortgage servicing rights (MSRs) and mortgage servicing advances. These assets are critically important to the housing finance system and its stability and warrant consideration as eligible assets. GSE and Ginnie Mae servicing advances, for instance, are the first payment priority and receive cash first when loans re-perform, pay off, or are resolved through foreclosure. The significance and commitment institutions place on fulfilling these advances is a clear indication of the value of this asset and demonstrates the potential for it to be used as a very safe option for collateral purposes.

The pledging of quality collateral to secure FHLB advances is the foundation of safety and soundness of the FHLBs. Under the existing regulatory structure, each FHLB may restrict the types of collateral that it will accept based on the credit profile of the borrower and the quality of the collateral, among other reasons. Each FHLB also maintains the ability to set collateral valuation procedures.

The types of collateral that can be pledged by members under the current system should remain in place, but any comprehensive review of the FHLB System should also include examining the ways in which the FHLBs can perform their critical mission as a liquidity backstop by expanding eligible collateral types. A comprehensive review of the collateral risks by FHFA and the Banks, with stakeholder and expert input, should be conducted to identify specific risks posed by MSRs, servicing advances, and other assets under consideration. To the extent FHFA and the Banks deem certain collateral types to be riskier or more volatile than agency MBS or whole loans (for example, interest rate-sensitive MSRs), the FHLB maintains discretion to set collateral-specific haircuts that reflect this risk.

IV. Conclusion

MBA believes the membership and collateral changes outlined above would more accurately reflect the breadth of institutions that contribute to the national system of housing finance and community investment activities, in effect creating a "21st Century" FHLB System. The responsible expansion of FHLB membership would strengthen the System's ability to make our housing and community development finance markets more resilient, improve the Banks' earning capacity, and provide greater support for their mission. Strengthening and modernizing the System's safety and soundness requirements will also be an important step in the future of the FHLBs. MBA looks forward to continuing these conversations in the months ahead, continuing our partnership with FHFA on this critically important housing issues.

Thank you in advance for your consideration of these comments. Should you have questions or wish to discuss further, please contact Pete Mills, Senior Vice President of Residential Policy and Member Engagement, at (202) 557-2878 and pmills@mba.org,or Mike Flood, Senior Vice President of Commercial and Multifamily at (202) 557-2745 and mflood@mba.org.

Sincerely,

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President and Chief Executive Officer
Mortgage Bankers Association