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The Honorable Sandra Thompson
Director
Federal Housing Finance Agency
Constitution Center
400 7th Street, SW
Washington, D.C. 20219

RE: FHFA Review of the Federal Home Loan Bank System

Dear Director Thompson:
I am writing on behalf of 283 banks that make up the membership of the Iowa Bankers Association (IBA). The IBA is the principal advocate for banking in Iowa. We are also the largest state banking association in the country. Although our membership includes institutions of all sizes and scope, the bulk of our membership is comprised of community banks serving rural Iowa. As a result, any change to the Federal Home Loan Bank system could have a dramatic impact on credit availability and economic growth in rural parts of our state. These are areas already challenged by demographic trends, technological change and continued consolidation in agriculture.

The Des Moines FHLB has long been a critical bank partner by supplying funding to support lending for homes, small businesses and agriculture. Changes to the system could threaten this partnership, directing funds away from rural America. We especially benefit from our district bank being local. Only by residing in the district can FHLB employees fully appreciate economic conditions and recognize opportunities to collaborate in addressing housing and other community needs.

Many of our banks have also partnered with the DM FHLB in addressing affordable housing needs. This continues to be one of Iowa's most significant challenges, as housing inventory remains low, interest rates rise and home prices remain high. The housing affordability index has fallen dramatically over the past year, with no relief in sight.

Our banks have also invested significant capital into the FHLB system. Should membership criteria change, or less regulated entities be allowed to access the system, our investment could be at risk

I strongly urge you to preserve the essential structure and membership of today's FHLB. If change is considered, I would urge you to consider reducing the discount on non-housing loans used as collateral for advances. We are already starting to see community bank liquidity challenges return, following the deposit influx from government pandemic assistance programs. As a result, DM FHLB advances have more than doubled since the first of the year.

Another issue we are hearing about regards FHFA's usage of tangible capital in assessing a commercial bank's credit worthiness for purposes of issuing advances. Although bank capital regulations were updated a decade ago, 12 CFR Section 1266.4, directs the Federal Home Loan Banks (FHLBs) to use tangible capital in assessing a commercial bank's credit worthiness for purposes of issuing advances. In the event that a bank does not meet the required tangible capital levels, it could be denied access to the FHLB advance system unless its Primary Federal Regulator (PFR) requests in writing that an advance be made or rolled over.

The Iowa Bankers Association (IBA) believes this misalignment could lead to significant administrative bottlenecks between the FHLB and the banking regulators, particularly given today's unique combination of monetary tightening and pandemic-driven composition of bank balance sheets. To ensure that the Federal Housing Finance Agency (FHFA) is using the most up-to-date capital definition, we recommend that the agency modify Section 1266.4 so that it looks to Tier 1 capital, as defined by the FDIC in Part 324.2. This could be done most efficiently through an interim final rule.

IBA believes that Tier 1 capital, as defined by the prudential regulators, offers the best assessment of a bank's financial condition. As it currently stands, the FHFA and the banking agencies adjust GAAP capital in different ways, resulting in different capital levels for the same institution, which can cause confusion. Consistency of capital definitions across regulations is necessary, then, to avoid unintended consequences arising from the way market and economic events are measured and accounted for under different capital regimes.

One key difference between FHFA tangible capital and bank regulatory capital is that the bank capital regime allows all but the largest banks the option of excluding unrealized gains and losses on Available For Sale (AFS) debt securities so that market swings do not affect regulatory capital levels. Under the FHFA's calculations, however, unrealized gains and losses on AFS securities "flow through" to tangible capital, creating unnecessary capital volatility. As the bank regulators have recognized, looking to tangible capital could create confusion and, in a rising interest rate environment such as today's, incorrectly suggest that otherwise sound banks are not creditworthy for purposes of access to FHLB advances. As the FHFA is aware, throughout the pandemic bank customers sought the safety of bank deposits, some of which banks invested in short-term, high quality liquid securities. Accordingly, the vast majority of securities currently held by banks are U.S. Treasury, GSE or municipal securities – securities that have minimal credit risk. However, the Federal Reserve's move toward a less accommodative monetary policy stance means that markets are adjusting to a new environment, and as such, valuations of even the safest securities are affected.

Making this change in the near term, prior to any future stress, would help to ensure that banks have seamless access to an important liquidity tool without compromising the FHLBs' ability to screen for troubled institutions or work with a bank's PFR. Failure to fix this inconsistency in the regulations may exacerbate a stress as banks continue to navigate rising rates and the ongoing macroeconomic volatility. This in turn may impair banks' ability to provide credit to US businesses and households, especially the more vulnerable sections of our economy. We encourage the FHFA to work closely with the bank regulators to better align their regulations.

Thank you for your thoughtful review of the FHLB system and for considering or views.

John Sorensen
President & CEO