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March 31, 2023

Sandra Thompson  
Director  
Federal Housing Finance Agency  
400 7<sup>th</sup> St SW  
Washington, DC 20024

RE: FHLBank System at 100: Focusing on the Future

Dear Director Thompson:

The Independent Community Bankers of America (ICBA) thanks FHFA for conducting a thoughtful and thorough review of the Federal Home Loan Bank (FHLB) System as it looks to the future and considers potential changes regarding the System's mission in the housing finance space after nearly a century. ICBA appreciated the opportunity to participate alongside industry stakeholders to emphasize the crucial role of the FHLBs as indispensable sources of liquidity. These written comments are intended to underscore ICBA's long and consistent position that FHFA should not make unnecessary changes to the FHLBs that may compromise them as strong, stable, and reliable sources of funding for community banks and the communities they serve throughout the nation.

As stated during the listening sessions and in our previous comment letter, over ninety-five percent of ICBA members belong to their regional FHLB and many of our members participate on the FHLB boards and committees. The FHLBs have been a key part in helping community banks drive economic development and housing in the communities they serve for ninety years. We therefore urge FHFA to first do no harm to a System that remains safe and sound and consistently fulfills its mission. This is particularly true now given recent heightened market uncertainties coupled with the challenges accompanying a rising interest rate environment.

Community banks and the FHLBs have enjoyed a long and successful relationship over the past ninety years. Many participants during the roundtables and listening sessions shared stories and data that highlighted how indispensable the FHLBs are to the community bank business

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model. Community banks provide local knowledge and local contacts with home builders, small businesses, economic development officials, and community leaders. The FHLBs in turn provide the necessary liquidity needed to complete many local projects. The FHLB System expands and contracts as needed, depending on the level of economic activity and the level of bank deposits required to meet the lending needs of local customers. While some have suggested the System does not adequately meet the needs of today's market or that there are enormous flaws in its operations. Our members – who provide the capital to the System – can attest that the System works very well and largely functions as intended by Congress.

One of the main reasons the FHLB System has worked so well for ninety years is that the FHLBs deal primarily with insured, prudentially regulated depositories that are also member-owners – banks and credit unions, along with certain CDFIs and insurance companies. These are the entities that have the capital and balance sheet capacity to hold the eligible collateral - in either whole loan form or in securities - to secure an advance from the FHLBs. In the case of a failure of a member bank or credit union, this collateral can be easily liquidated by a FHLB and the advance repaid. Further, in the case of a bank or credit union failure, the FDIC and NCUA provide the FHLBs the ability to “seize and liquidate” any collateral that secures an advance prior to the full resolution of the troubled institution, which then shields the FHLBs and its members from a loss. While insurance companies are not federally regulated, the FHLBs work with state insurance regulators to obtain similar agreements.

Throughout the various recessions and market challenges over the last ninety years – including the 2007 financial crisis, the savings and loan crisis of the late 1980s, and the recent pandemic – there has not been a failure of a single FHLB, and taxpayers have not been called upon to support the FHLB System through a bailout.

### **ICBA Feedback**

It is critical that community banks can access FHLB advances during times of economic stress or when there are opportunities to increase lending, participate in a local project, or help first time homebuyers. In recent months, there has been a growing concern about access to liquidity in the banking system, as evidenced by the experiences of several larger regional banks. In response, the FHLBs quickly issued debt of nearly \$300 billion, shoring up the liquidity of these institutions and supporting the broader banking and financial system. This is what it was designed to do.

Recent events also highlight a concern about community bank access to FHLB advances due to inconsistent capital regulations between FHFA and the Primary Federal Regulators (PFR). FHFA's capital regulations determine minimum tangible capital by counting temporary unrealized losses against tangible capital. Due to recent economic volatility and rapidly rising interest rates, even the safest securities are experiencing unrealized losses in Available For Sale portfolios. If unaddressed, this trend could undermine otherwise safe and sound community banks' access to liquidity through the FHLBs. We strongly urge you to work with the PFRs to address this regulatory inconsistency.

During some of the listening sessions it was suggested that FHLB advances should be contingent on members meeting certain lending thresholds that reflect mortgage activity. Respectfully, this would be a mistake. Assigning arbitrary percentage requirements unfairly impacts lenders with smaller mortgage volumes, especially those that may have significant fluctuations in lending activity year over year. Similarly, some have suggested tracking FHLB advances to somehow ensure they go towards housing. Just like a typical loan, an advance is fungible. ICBA therefore cautions that a tracking mechanism will likely present undue complications and potentially constrain or disrupt how members conduct their day-to-day balance sheet management.

Additionally, some have suggested that the FHLBs should contribute more of their earnings to the Affordable Housing Program. It is possible that the FHLBs could be doing more for affordable housing – indeed, many exceed their mandated contributions. However, ICBA urges FHFA to work with the FHLBs to ensure there is an adequate balance between sound financial management, member-owner obligations, and contributions to affordable housing. As others have also stated, overly disrupting this balance may have unintended consequences for the System as a whole and its long-term viability.

Other issues include changes to membership to the FHLB System and the types of eligible collateral. It is crucial that FHFA continue to recognize that FHLB members must be safe and prudentially regulated. Adding new, under-regulated members will have a negative impact on the safety and soundness of the System. Restricting access to the largest banks would also upset the funding balance that helps make the System meet the needs of its members. Moreover, FHFA must be careful not to introduce esoteric and volatile forms of collateral that will lead to increased risk within the System, a greater possibility of losses, and a potential failure of a FHLB. This will increase costs for all who rely on the System and will fall hardest on

the smallest institutions that depend on the System and do not have alternative access to the capital markets or other sources of wholesale liquidity.

## **Conclusion**

The FHLBs must remain a strong, stable, and reliable source of funding for community banks. As such, ICBA opposes any changes that would:

1. Compromise the System's regional and cooperative structure.
2. Permit non-depository entities — which are not prudentially regulated — access to FHLB programs or services.
3. Restrict large banks from membership.
4. Consolidate the System without the grassroots leadership of its member-owners.
5. Apply a mandatory thrift test requiring community banks to maintain an arbitrary percentage of their assets in residential housing, or initiate tracking mechanisms for advances.

ICBA commends FHFA's efforts to conduct a thorough review of the FHLB System, and we look forward to working together in the coming months when FHFA releases its recommendations.

Sincerely,

Ron Haynie  
Senior Vice President- Housing Finance Policy