FHFA FHLB Comprehensive Review
FINAL Freedom Written Comments 3/31/23

Introduction

We continue to believe that thoughtfully expanding membership eligibility of the Federal Home Loan Banks is critical to positively impacting the achievement of the FHLB mission to provide reliable liquidity to support affordable home financing across the country. When overlaid upon today's housing finance system, the current membership constraints and regulatory framework simply do not facilitate any meaningful enhancement of the FHLB goals, given the exclusion of non-bank mortgage companies that account for around 60% of originations overall, and more importantly almost 90% of FHA, VA and USDA lending.

Key to doing so, 1) the statutory and regulatory restrictions must be modernized to allow for membership expansion that better meets the FHLB mission, and 2) the Banks themselves must be willing to expand their risk and control framework to accept collateral such as mortgage servicing rights (MSRs) that are foundational to today's contemporary housing finance system.

On these points, we offer our perspectives below in addition to the comments submitted earlier in this process on "how" FHLB membership could be thoughtfully and responsibly expanded for the benefit of increasing the FHLBank's role in providing affordable mortgage financing, and the additional benefit of the potential systemic reduction of liquidity risk to which non-bank mortgage companies are exposed.

Membership Expansion

As described in our comments submitted previously at the beginning of this Comprehensive Review, we believe that there are two potential paths to expanded FHLB membership that would allow eligibility for independent mortgage companies and other market participants that clearly support the affordable housing mission of the Federal Home Loan Banks.

Administrative Change

Firstly, the FHFA has the administrative authority to modify the existing Final Rule on FHLBank Membership published in January 2016 that significantly narrowed the definition of "insurance company" and thus eligibility as affiliates for many of the contributors to affordable housing finance in today's contemporary market.

While we recognize the implications of reverting to the existing rule's definition, doing so would clearly be the most expedient path to expanding membership and meaningfully impacting the accomplishment of the System's affordable housing mission.

Legislative Change

In parallel, FHFA should include recommendations for Congress to expand FHLB membership through statutory changes by amending the Act itself, as has been done to add other categories of now-qualified institutions (e.g. CDFIs) since its enactment. Today's actual residential mortgage market is worlds apart from the market of the mid-2000s, and exponentially far more so from the mortgage market that is reflected in the 1932 Act. We believe the housing finance system would be best served by amending the Act to explicitly include non-bank mortgage companies, ensuring that the core mission of supporting affordable housing financing liquidity and that the System itself remains relevant to achieve that mission.

This is certainly a longer-term effort but would ensure the certainty of membership regardless of potential changes to regulatory rules and definitional interpretations that could occur across administrative changes.

Collateral Acceptance

Non-Bank Collateral Availability

The acceptance of collateral by any or all FHLBanks to secure advance lending is a critical gating question to membership and prudent FHLB system participation. However there are limited options for non-bank mortgage companies to offer collateral given the monoline nature of the business.

For non-bank mortgage companies that own mortgage servicing rights (MSRs), we contemplate the pledging of non-bank's MSR assets for use as FHLBank advance collateral. This can be accomplished using either a securitization structure that can be rated by an independent rating agency such as KBRA to be pledged as a security for an advance or a bilateral agreement entered into between a FHLB and a non-bank mortgage company.

Structural and Risk Management Framework Changes

FHLBank membership expansion would require FHFA to consider how the System would absorb new participants, which would expose the system to a different risk profile. We've contemplated two options for a structural framework under which expanded membership could be managed by the Banks.

Option 1: Create a special-purpose FHLBank (SPB) that would be responsible for the management of its impact on the joint-and-several liability structure of the system as a whole. Specialized resources, systems and processes could be focused uniquely on mitigating such risk, including membership oversight and collateral valuation.

Option 2: Maintain the regional nature of FHLBanks and embed distributed risk management competencies and processes into each individual Bank.

As a prospective member applicant, we do not have an operational preference for either of these two options and certainly understand the complexity and resource challenges of implementing either one, however it is a necessary consideration in understanding how a proposed membership expansion might be successful.

Conclusion

As we noted in our previous written comment submission, the FHLBanks exist to help member institutions meet the housing credit needs of the communities they serve across the country, during all economic cycles, especially in low- to moderate-income, minority and rural areas. At inception, it was recognized that the true mission of the system was for the benefit of homeowners - not institutions of a particular type. Non-bank mortgage companies such as independent mortgage banks exist solely for this purpose, and make up the overwhelming majority of affordable housing finance in today's market.

None of these changes would be simple. Membership expansion – no matter which path is taken – would require significant resource investments both by FHFA and within the FHLBanks themselves. As importantly, such a change would require broad process changes that would have an impact on all current stakeholders in the current System. On balance, however, we believe that the likely benefits of greater contributions to quality, equitable and affordable housing finance through lower costs and expanded contributions to programs such as the Affordable Housing Program makes these investments worth such an effort.

We thank the FHFA and especially Director Thompson for her leadership in engaging all stakeholders in this Comprehensive Review and welcome any opportunity to continue this conversation around the benefits of FHLBank membership expansion and further detail about these key topics.