FHLBANKS
A NATION OF LOCAL LENDERS

March 23, 2011

VIA E-MAIL TO REGCOMMENTS@FHFA.GOV

Alfred M. Pollard, Esq., General Counsel
Attention: Comments/RIN 2590-AA37
Federal Housing Finance Agency, Fourth Floor
1700 G Street, N.W.
Washington, D.C. 20552

**Re: Advance Notice of Proposed Rulemaking; Request for Comments – Members of the Federal Home Loan Banks**

Dear Mr. Pollard:

The twelve Federal Home Loan Banks (FHLBanks) are writing to comment on the Federal Housing Finance Agency's (FHFA) advance notice of proposed rulemaking and request for comments on "Members of the Federal Home Loan Banks" published on December 27, 2010 (ANPR).[1] The ANPR reviews current statutory and regulatory provisions governing FHLBank membership, discusses possible regulatory changes to the membership requirements, and invites comments on the possible alternatives. The FHLBanks appreciate the FHFA's attention to this topic and welcome the FHFA's invitation to provide comments on all aspects of the ANPR.

## I. GENERAL COMMENTS

### A. Congressional History Suggests an Expansive View of FHLBank Membership and Mission

The FHLBanks are concerned that a proposed rule that restricts membership eligibility or narrows the FHLBanks' mission contradicts the historical tendency of Congress, particularly in recent decades, to statutorily broaden the field of FHLBank membership and the types of acceptable collateral for FHLBank funding. When the FHLBanks were first created, FHLBank membership consisted of thrifts and insurance companies. In 1989, Congress expanded membership to include commercial banks and credit unions. See Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA), Pub. L. No. 101-73, 103 Stat. 183 (August 9, 1989). Most recently, in 2008, Congress authorized community development financial institutions to become members of the FHLBanks. See Housing and Economic Recovery Act of 2008 (HERA), Pub. L. No. 110-289, 122 stat. 2654 (2008).

The FHLBanks' mission was expanded by the Gramm-Leach-Bliley Act of 1999 (Pub. L. 106-102, 113 Stat. 1338 (1999)) (GLB Act) when Community Financial Institutions were allowed to pledge small business, agribusiness and agricultural loans as collateral for advances. The GLB Act also lessened the FHLBanks' emphasis on housing finance by eliminating (i) the statutory priority for advances to Qualified Thrift Lenders (QTLs); (ii) the 30% FHLBank

[1] 75 Fed. Reg. 81145.

System-wide cap on advances to non-QTL members; and (iii) the advance-based stock purchase requirement for non-QTL members. Thus Congress ensured that all FHLBank members had equal rights to funding and were full participants in the FHLBank System's mission.

In section 1201 of the 2008 HERA legislation, Congress explicitly recognized the FHLBanks' mission of providing liquidity to members without limiting that purpose to housing finance. The FHLBanks' ability to fulfill this statutory mandate was clearly demonstrated during the recent financial crisis, in which the FHLBanks provided liquidity to their members during the early stages of that crisis. We are concerned that imposing additional regulatory restrictions on membership beyond those currently in place may impair the FHLBanks' ability to fulfill this important statutory purpose in the future.

Congress has had many opportunities to clarify the housing finance requirements if it believed its intent was not being followed but it has left these provisions untouched. Also, Congress appears to be poised again to comprehensively review the role and mission of the FHLBanks as part of the reform effort for government sponsored enterprises. We believe that the current rules are working well, but if changes are needed, we believe that Congress should be allowed the first opportunity to act before the FHFA imposes significant new requirements in the membership area.

B. New Membership Requirements Could Deter Insurance Companies from Joining and Using the FHLBanks

Insurance companies have been eligible to be members in the FHLBank System since the Federal Home Loan Bank Act (Bank Act) was enacted in 1932. They remain an important and valuable component of membership, accounting for 10% of outstanding combined advances, and 8% of capital stock, as of September 30, 2010. Further development of this sector presents a tremendous opportunity for the FHLBanks to increase their impact on housing finance and community and economic development.

The FHFA has raised concerns regarding captive insurers. Captive insurers are subject to the same regulatory bodies and oversight as are other insurance companies. Similar to other insurers, the ability of captives to either lend money or pay dividends to affiliated organizations is tightly regulated and generally requires prior review and written approval from the State insurance commissioner. While captive insurance company business models are diverse, only those that support the housing mission, as required by current regulations, are approved for membership. As the FHLBanks are collateral lenders, advances to captives are only supported by mission-related eligible collateral. Captives are subject to robust FHLBank credit requirements, similar to other FHLBank members, which requirements provide incentives to expand commitment to housing and community and economic development.

Finally, at some FHLBanks, insurance company members have proven to be an important conduit for promoting housing and community and economic development by actively participating in, and obtaining, Affordable Housing Program (AHP) grants and Community Investment Cash Advances (CICA).

C. Existing Regulations are Working Well

The FHLBanks believe that the current membership regulations are working well. The FHFA does not identify in the ANPR a benefit that it hopes to achieve by changing the membership rules to require continuous compliance with the initial eligibility requirement that an institution have at least 10% of its total assets in residential mortgage loans. The FHFA's own initial research shows the vast majority (about 98%) of FHLBank members currently comply with the 10% requirement and another 1% have more than 9% of their assets in mortgages.

The presumptive compliance and rebuttable approaches of the current regulations have served the FHLBanks well for over a decade. As the FHLBanks have the authority to approve membership, they should continue to have the authority to use their discretion in membership issues that arise in their unique mix of members.

The FHFA has not identified any harm in the ANPR that needs to be remediated. In fact, the FHFA has even indicated that a member that no longer meets the initial membership requirements is not especially "troublesome". In the FHFA's analysis of why an FHLBank may treat a bridge depository institution as continuing the membership of a failed member, the FHFA stated a bridge bank's "failure to meet membership requirements need not be more troublesome than in the case of a more typical member institution that, while meeting membership requirements initially, has fallen out of compliance, as the institution's membership does not immediately terminate upon noncompliance with the Federal Home Loan Bank membership requirement." See FHFA 2010-RI-04. Although the failure to meet certain requirements may indicate potential problems at a member institution, the failure to meet those membership requirements shouldn't automatically terminate the institution's membership nor should an FHLBank be required to terminate the membership.

Additionally, the FHLBanks' housing finance nexus is supported by several existing regulatory requirements and limits. The Residential Housing Finance Asset (RHFA) test[2] supports the FHLBanks' housing finance mission by limiting the amount of long-term advances members are able to take down to the amount of total residential housing long-term assets they currently hold. Finally, the Community Support Statement requires all members to periodically certify that they actively support the first-time home buyer market in order to access long-term advances and CICA funding.

D. New Continuous Membership Rules Would Diminish the Perceived Reliability of FHLBanks and Threaten the Stability of FHLBank Capital Stock Bases

The FHLBanks are concerned that, by requiring members to meet ongoing requirements, the FHFA is introducing an element of uncertainty and instability to FHLBank membership. Members could never be sure of their ability to meet these tests and therefore maintain their access to FHLBank liquidity and funding products, particularly in times of financial stress, such as the recent financial crisis. For example, in periods when mortgage valuations rapidly decline, as we recently experienced, members could not be assured of maintaining at least 10% of their

[2] 12 C.F.R. § 1266.3(b)(1).

assets in mortgages. A member's asset mix could change due to its strategy or other reasons, as well. As a result, a FHLBank would be viewed by both existing members and potential members as a far less reliable funding partner.

To the extent that new membership rules result in more members being terminated for failing to comply with these rules, the capital stock bases of the FHLBanks would become more volatile and less stable as stock is redeemed or repurchased. This could impact the capital adequacy of the FHLBanks, as well as the stability of the System and its effectiveness in meeting national housing finance and community development policy objectives.

E. The Ability of FHLBank Members to Support the Economic Recovery Could be Harmed

As the country works to generate economic growth, create jobs and recover from the financial crisis and housing downturn, the FHLBanks play an important role as a source of liquidity and term funding for their member institutions. As Congress intended, FHLBank funding is used by members to provide traditional and sustainable residential mortgage finance as well as to support community development and affordable housing activities in their communities, thus helping their local economies to recover.

By requiring continuous compliance with initial membership requirements, the FHFA would impose new regulatory burdens on the FHLBanks' members, particularly smaller institutions. President Obama's new executive order on Federal regulations encourages a more balanced approach and emphasizes that Federal regulators should find the simplest, least costly and least burdensome way to implement new requirements. The President is asking for government regulation to support, not undermine, economic growth and job creation.

We respectfully suggest that the FHFA's focus should be on considering ways to allow the FHLBanks to expand their roles by increasing FHLBank membership among eligible institutions and, where appropriate, increasing use of advances among existing members. Tightening membership requirements and narrowing the eligibility for certain classes of institutions would be counterproductive to current economic recovery efforts.

## II. COMMENTS ON THE SPECIFIC QUESTIONS POSED IN THE ANPR

### A. The 10 Percent Requirement

**Question One**: Should FHFA revise § 1263.10 of its regulations so that an insured depository institution that is subject to the 10 percent residential mortgage loan requirement when it is admitted for membership must also comply with that requirement for the duration of the time that it remains a member?

**Question Two**: Should FHFA amend §§ 1263.6(b) and 1263.10 of its regulations to subject insurance companies and CDFI applicants to the 10 percent residential mortgage loans requirement?

**Question Three**: If FHFA does not subject insurance company and CDFI applicants to the 10 percent requirement, should FHFA amend § 1263.6(c) of its regulations, which currently requires all such applicants to have mortgage related assets that reflect a commitment to housing finance, to establish levels of mortgage-related assets that may be deemed to constitute a sufficient commitment to housing finance?

**Response:** The FHLBanks do not believe that any of the changes proposed by the FHFA to the 10% requirement are necessary. The FHLBanks are concerned that if any of the FHFA's proposals is adopted, the FHFA would be effectively mandating a member's asset allocation, regardless of a member's use of FHLBank services, and would thereby create a regulatory burden on members and the FHLBanks. Additionally, the FHLBanks are concerned that making the 10% of mortgage assets requirement ongoing would greatly diminish the reliability of the FHLBanks as a general liquidity source and, in fact, might destabilize our membership base. The ramifications of members failing the test at some point in time but then later satisfying the requirement would disrupt the workings of the FHLBanks because institutions might be required to terminate their memberships and redeem their capital stock only to later re-qualify and possibly rejoin their FHLBank.

The FHFA's proposal to expand the scope of the 10% requirement to insurance companies or CDFIs runs contrary to the statute. Section 4(a)(2)(A) of the Bank Act provides that "[a]n **insured depository institution** that is not a member on January 1, 1989, may become a member of a Federal Home Loan Bank only if . . . the **insured depository institution** (other than a community financial institution) has at least 10% of its total assets in residential mortgage loans." 12 U.S.C. § 1424(a)(2)(A). As can be seen from the statutory language, Congress clearly intended to apply the 10% requirement only to "insured depository institutions." If the intent of Congress was to expand the applicability of this requirement to insurance companies and CDFIs, Congress had the opportunity to do so when it approved CDFIs for membership in 2008. Since Congress did not take this action, any proposal to broaden this requirement to insurance companies and CDFIs would run contrary to the clear Congressional intent that this requirement apply to "insured depository institutions."

Insurance companies lack access to the Federal Reserve discount window and yet are subject to the same "run-on-the-bank" phenomenon. They are also subject to catastrophic, mortality, morbidity and other liability risks unique to their policyholder liabilities. As a result, prudent asset allocations for insurers must have greater diversification, cash flow certainty, and liquidity than those of depository institutions. After becoming an FHLBank member and integrating advance usage into their business strategies, insurances companies can prudently increase mortgage holdings and/or maintain portfolio weightings through periods of stressed liquidity. In addition, FHLBank insurance company members are able to access CICA and AHP funds which can be important conduits to further the FHLBanks' public policy mission.

Furthermore, as the FHFA noted in the ANPR, the Federal Housing Finance Board (FHFB, the FHFA's predecessor) considered applying the 10% of mortgage assets requirement to insurance companies in 1993. In the end, the FHFB decided not to apply

the 10% requirement to insurance companies but instead to require insurance companies to meet an alternative requirement that they have "mortgage-related assets that reflect a commitment to housing finance." The FHFB stated that this "alternative test recognizes the differences in the lines of business of the banking and insurance industries." 58 Fed. Reg. 43522, 43532 (Aug. 17, 1993). This rationale remains persuasive today. Additionally, the application of this requirement to CDFIs was recently addressed by the FHFA when it published its final rule on membership for CDFIs. In the final rule, the FHFA addressed comments requesting the FHFA revise the definition of "residential mortgage loans" to bring the definition more in line with the business of CDFIs. In declining to make changes to the definition, the FHFA stated that the "10 percent requirement applies only to depository institutions and this is not relevant for CDFI members." 75 Fed. Reg. 678, 682 (Jan. 5, 2010).

The FHFA's suggested changes would have a significant impact on insurance company members and potential applicants. Based on 2009 financial data, applying the 10% mortgage assets requirement to insurance companies would impact over 50% of current FHLBank insurance company members and would prevent nearly 70% of insurance companies that are potential FHLBank members from becoming members. Moreover, in raw dollar terms, insurance company members hold large amounts of mortgage-related assets with the potential to positively impact housing and community and economic development through FHLBank membership. Expanding the 10% mortgage assets requirement to insurance companies would only diminish this potential.

Finally, the FHLBanks believe that current usage requirements, such as the residential housing finance asset test and the Community Support Statement certification, ensure that members demonstrate a commitment to housing finance and therefore we do not believe that any changes are needed to these sections.

B. The "Makes Long-Term Home Mortgage Loans" Requirement

**Question Four:** Should FHFA revise § 1263.9 of its regulations to require that an institution that is admitted to membership must comply with the "makes long-term home mortgage loans" requirement both at the time that it is admitted for membership and for the duration of the time that it remains a member?

**Question Five:** Should FHFA replace the existing standard, which requires only that an institution demonstrate that it originates or purchases home mortgage loans, with one or more quantifiable standards, such as by requiring applicants and members to have a specified portion of their assets invested in long-term home mortgage loans or by meeting the minimum dollar volume of originations and purchases of such loans?

**Question Six:** If FHFA were to adopt a standard based on a minimum percentage of long-term home mortgage loans, what would be an appropriate level of long-term home mortgage loans or mortgage-backed securities to be held by depository institutions, insurance companies, or CDFIs, respectively?

**Question Seven:** If FHFA were to replace the existing regulatory requirement with a quantifiable standard, should FHFA apply one standard to all eligible institutions and members, or separate standards for the three distinct categories of institutions that are eligible for membership?

**Question Eight:** If FHFA were to establish separate quantifiable standards for the separate categories of eligible institutions, should it also establish separate sub-categories for different types of institutions within each category and property and casualty insurance companies?

**Response:** Section 4(a)(1)(C) of the Bank Act requires that every applicant for membership must make long-term home mortgage loans. An applicant can satisfy this requirement by originating or purchasing long-term home mortgage loans, which includes the purchase of mortgage-backed securities. The statute does not set a minimum threshold for the amount of home mortgage loans an applicant must make in order to satisfy this requirement nor does the statute characterize this requirement as an ongoing requirement. Similar to our response to the 10% mortgage assets requirement questions, the FHLBanks believe there are regulations currently in place to ensure that members continue to comply with the "makes long-term home mortgages" requirement. For example, an FHLBank, prior to approving an application for a long-term advance, must determine that the principal amount of all long-term advances currently held by the member does not exceed the total book value of residential housing finance assets held by such member.

In 1999, under the GLB Act, the authority to approve membership applications was delegated from the FHFB to the individual FHLBanks. The delegation of this authority allowed each FHLBank to implement policies governing approval of applicants for membership that are appropriate for its business, such as whether advances may be safely made to an applicant, and its district. We believe that this flexibility has worked well and has allowed the FHLBanks to provide liquidity to a broad range of member financial institutions, including during the recent financial crisis.

C. <u>The Home Financing Policy Requirement</u>

**Question Nine:** Should FHFA revise § 1263.13 of its regulations to require that an institution that is admitted to membership must comply with the "home financing policy" requirement both at the time that it is admitted for membership and for the duration of the time that it remains a member?

**Question Ten:** Should FHFA define the term "home financing policy" and, if so, how should that term be defined? Should it be defined to include only a written policy that describes in narrative fashion the manner and extent to which the applicant's past and current activities and investments support home financing, or should it also be defined to include certain business practices, such as having specified levels of mortgage related assets above which an acceptable housing finance policy could be presumed?

**Question Eleven:** Should the regulations allow the specifics of a home financing policy to vary based on the type of institution? Should FHFA recognize that originating mortgage loans and investing in mortgage loans and mortgage related securities may constitute the core business of certain thrift institutions, while those same activities may constitute only an incidental portion of the business of other eligible institutions, such as insurance companies?

**Question Twelve:** Should FHFA continue to use an institution's CRA rating as a proxy for compliance with the home financing policy requirement or should FHFA develop an alternative approach for assessing compliance with this requirement? One such alternative could be to develop a quantifiable standard, such as one based on a minimum level of housing related assets, which could be used either alone or in conjunction with the CRA rating, for determining whether an institution has an acceptable home financing policy.

> **Response:** Members are already subject to an ongoing home financing compliance requirement. Currently, members are selected randomly every two years by the FHFA to complete the Community Support Statement. The Community Support Statement requires members to certify that they actively support the first-time home buyer market in order to access FHLBank long-term advances and CICA funding. The FHLBanks believe that using the Community Support Statement to assess a member's support of home financing is more accurate than reviewing a member's home financing policy on an ongoing basis, or even a member's CRA rating. The CRA rating was not designed to measure an institution's support of home financing but to measure how well a member was meeting the credit needs of its community.

D. Captive or "Shell" Insurance Companies

**Question Thirteen:** Should FHFA amend its membership regulations to require that insurance company applicants be actively engaged in underwriting insurance for third parties and be actively examined and supervised by their appropriate state insurance regulator, and that insurance company members remain so engaged and so examined and supervised as a condition to remaining Bank members?

> **Response:** The FHFA questions whether "shell" insurance companies and "captive" insurance companies adequately satisfy all the requirements of membership and therefore should be precluded from membership. The FHLBanks are not clear what entities the FHFA is referring to when requesting comments on membership eligibility for "shell" insurance companies. All insurance companies must be regulated in order to be eligible for FHLBank membership under the current membership regulations. Captive insurance companies, or "captives," are formed to underwrite risks of their parent company or affiliated groups. They are licensed and comprehensively regulated by the state or domicile where formed by the same agencies as other insurance companies. In fact, over 35 states have laws that expressly govern captive insurance companies and under these laws, captives are generally subject to the same terms and conditions pertaining to administrative supervision, conservation, rehabilitation, receivership, and liquidation as other insurance companies.

Like other insurers, captives determine the risks to be underwritten, set the premium rates based on market conditions, write policies for the risks insured, collect premiums, and pay out claims for insured losses. Captives also have reserves, surplus, policies, policyholders, and claims. Captives are primarily formed to provide customized, flexible, efficient, and economical risk transfer solutions versus what is commercially available. As such, captives increase economic efficiency and activity.

The primary differences between a captive and a commercial insurer is that the captive is prohibited from doing business with the general public. This restriction, however, has no impact on the captive's nexus to the FHLBank's mission, nor does it impact the FHLBank's ability to lend to the captive in a safe and sound manner. Captives are subject to the same FHLBank membership regulations as other regulated financial institutions. Additionally, a captive, like any other FHLBank applicant, will only be approved for membership if it is "in a financial condition such that advances may be made safely to it." Captives are subject to robust credit and collateral policies, as are all members; these policies are self-reinforcing and encourage advance usage for housing-related purposes and provide incentives to increase commitment to housing and community and economic development.

E. Sanctions for Noncompliance

**Question Fourteen:** Should FHFA amend the membership regulations to address the possibility that a member might not comply with, or might later fall out of compliance with, one or more of the new ongoing membership requirements after a transition period has expired, and if so, should FHFA require the Banks to terminate that institution's membership, either with or without a grace period, or should the FHFA consider lesser sanctions, such as prohibiting further access to Bank services during a specified grace period, before requiring the Banks to terminate the membership of the noncompliant members?

**Response:** The uncertainty in membership status created by imposing ongoing requirements is one reason such requirements should not be implemented. The ramifications of members potentially falling out of compliance with an ongoing requirement are significant if the noncompliance leads to a member's membership being terminated. Would the member be subject to the five year lock-out before it would be eligible to rejoin an FHLBank? If, under an FHLBank's capital plan, the terminated member continues to hold stock in an FHLBank but comes into compliance prior to all of its stock being redeemed, would its termination of membership be cancelled?

At a minimum, the FHFA should grant the FHLBanks the flexibility to work with members that may experience temporary noncompliance with any new and ongoing membership requirements.

F. Regulatory Structure

**Question Fifteen:** Should FHFA retain the existing structure of its membership regulations, under which the regulations establish certain standards of "presumptive compliance" and allow

an opportunity for institutions that do not meet those standards to rebut the presumption of noncompliance, or should FHFA devise an alternative structure, such as one that incorporates "bright line" tests for each of the various eligibility requirements and does not create presumptions that an institution would be permitted to rebut?

> **Response:** The FHLBanks believe that the "presumptive compliance" standards work well and should not be changed. These standards provide the FHLBanks with the appropriate degree of guidance and discretion.

**Question Sixteen**: Should FHFA play a role in resolving close membership issues, or leave them to the discretion of the Banks?

> **Response:** Each FHLBank should continue to be allowed to resolve membership issues since each FHLBank district has its own unique mix of member types and is responsible for adhering to the FHLBank mission. There are already requirements in place that provide ample standards to guide the FHLBanks in resolving any close membership issues.

On a final note, if the FHFA decides to implement some or all of these provisions, the FHLBanks respectfully request that the FHFA consider either a grandfather clause for current members or, alternatively, a phase-in period for current members. The FHLBanks wish to ensure that all members will have ample notice of the changes and sufficient time to ensure they will be in compliance with any of the changes.

* * * *

We appreciate your consideration of these comments.

Sincerely,

FEDERAL HOME LOAN BANK OF ATLANTA

W. Wesley McMullan
President and Chief Executive Officer

FEDERAL HOME LOAN BANK OF BOSTON

Edward A. Hjerpe III
President and Chief Executive Officer

FEDERAL HOME LOAN BANK OF CHICAGO

Matthew R. Feldman
President and Chief Executive Officer

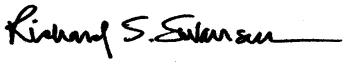
FEDERAL HOME LOAN BANK OF CINCINNATI

David H. Hehman
President and Chief Executive Officer

FEDERAL HOME LOAN BANK OF DALLAS

Terry Smith
President and Chief Executive Officer

FEDERAL HOME LOAN BANK OF DES MOINES

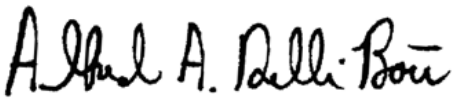


Richard S. Swanson
President and Chief Executive Officer

FEDERAL HOME LOAN BANK OF INDIANAPOLIS

Milton J. Miller II
President and Chief Executive Officer

FEDERAL HOME LOAN BANK OF NEW YORK



Alfred A. DelliBovi
President and Chief Executive Officer

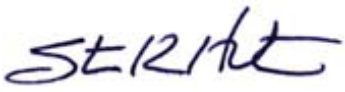
FEDERAL HOME LOAN BANK OF PITTSBURGH

Winthrop Watson
President and Chief Executive Officer

FEDERAL HOME LOAN BANK OF SAN FRANCISCO

Dean Schultz
President and Chief Executive Officer

FEDERAL HOME LOAN BANK OF SEATTLE



Steven R. Horton
Acting President and Chief Executive Officer

FEDERAL HOME LOAN BANK OF TOPEKA

Andrew J. Jetter
President and Chief Executive Officer