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March 28, 2011

Alfred M. Pollard, General Counsel
Attention: Comments/RIN 2590-AA39
Federal Housing Finance Agency
1700 G Street NW, Fourth Floor
Washington DC 20552

RE: Advanced Notice of Proposed Rulemaking RIN 2590-AA39/ 75 Fed. Reg. 81145 (12/2710) – Membership Requirements

Dear Mr. Pollard:

These comments are submitted on behalf of Guggenheim Partners (Guggenheim). I am the chief executive of the insurance division of Guggenheim. I am also a Lecturer in Law at the University of Chicago, where I teach insurance regulation.

Guggenheim is a diversified financial services company with over 1,500 employees located across the United States. Guggenheim has 5 life insurance company affiliates, 3 of which are wholly owned and operated, with total assets of over $50 billion. All 5 companies are members of the FHLB system. We additionally manage a like amount of assets for third party insurance company clients, many of whom are members of FHLB banks ("FHLBanks"). Guggenheim respectfully submits that the proposed rules do not further their stated aims, ignore the commercial realities faced by insurance company members, and may have the unintended consequences of increasing financial risks to insurance companies and the FHLBank system.

The ANPR's aims are to tighten membership requirements, both at the time of application and on an ongoing basis, with the stated view that such increased requirements would further the home finance mission of the FHLBanks. In particular, the ANPR would target insurance company members for the new requirements, the substance of which we believe to be unnecessarily burdensome. The increased burdens would be implemented in the form of new regulations requiring insurers to hold (1) 10% of their assets in "residential mortgage loans"; (2) pass new proposed tests for compliance with the "makes long term home mortgage loans" requirement; and (3) pass new proposed tests for complying with the home financing policy requirement.

Guggenheim believes that the ANPR is premised upon the following incorrect assumptions:

(1) More exclusive membership requirements will further promote the mission of the FHLBanks;

(2) Existing membership rules run the risk of conferring undeserved membership benefits and should therefore be tightened;

(3) Membership benefits can be obtained by members without fulfilling the mission of the FHLBanks;

(4) Insurance companies are more likely to be obtaining such membership benefits than depository institutions;

(5) In particular, captive or "shell" insurance companies pose a heightened risk of illicit membership to the FHLBank system.

Guggenheim respectfully submits that none of the above assumptions has any merit, either in logic or in fact. Furthermore, insurance company members are already subject to tighter regulations by each member FHLBank in terms of collateral and credit policy. Any additional burdens placed upon insurance company members--the original charter members of the system since 1932--will run the risk of further discouraging insurer membership.

1. Membership Requirements are Generally Unrelated to Promoting the Mission of the FHLBanks

The Home Loan Act of 1932, signed into law at the depths of the Great Depression, extended membership liberally on the basis of status as a regulated financial institution--at that time to thrifts and insurance companies. It was understood in 1932 that these institutions were the primary providers of capital formation and home lending. Commercial banks were not extended membership to the FHLBanks until 1989 upon the passing of the FIRREA legislation by Congress. As commercial banks have many federally supported avenues of raising capital for home lending including access to FDIC insured deposits and the Federal Reserve window, Congress placed a new requirement on commercial bank members precisely because FHLBank membership was not as essential to commercial banks as compared to the needs of insurance companies. Commercial banks did not require yet another federally supported source of home lending capital and therefore membership for banks was made contingent upon fulfilling the 10% residential mortgage holdings requirement (the "10% rule"). Congress was aware that insurers only had one source of funds that could economically be used to promote home lending and deliberately chose not to extend the 10% rule to insurers. In addition, Congress knew that the business model of commercial banks was dramatically different from that of insurers, such that the 10% rule would not be a binding constraint (e.g., the business of securitizing home loans would, as we have seen in the recent credit recession, entail the holding of large balance sheet positions by commercial banks in residential mortgage assets).

Importantly, Congress realized that membership regulation through uniform imposition of portfolio rules on state regulated insurance companies as a means of gating membership to the FHLBank system was bad policy. Unlike bank and thrift members, the business of insurers is more varied, complex, and subject to state regulation. There are as many types of insurers as there are types of insurable risks--health, life, longevity, catastrophe, disability--the list is long--and within each type of company there are different liability profiles on the balance sheet in terms of cost of funds, duration, and risks (the ANPR summary generalizations regarding insurer balance sheets on page 16 is not correct).

To take the important example of imposing the 10% rule on insurers: A 10% required minimum allocation to any asset class is a significant portfolio mandate. There is currently no such requirement under state law for insurance companies to maintain such an allocation. To do so without any consideration to the liability profile or funding utilization of the insurer is arbitrary and dangerous. To cite one example: imposing the 10% rule on annuity insurers as a membership requirement would be particularly harmful as mortgage assets and annuity liabilities have the same exposure to interest rates. When rates go up, annuity liabilities become shorter in duration while mortgage assets become longer; conversely, when interest rates go down, annuity liabilities become longer while mortgage assets become shorter. Annuity companies can manage these risks when *utilizing* FHLBank advances. But as a prior membership constraint, the 10% requirement increases the risk of annuity insurers prior to such utilization due the very specific nature of the business of annuity insurers. A one size fits all membership requirement mandating portfolio holdings is simply bad policy.

2. <u>The Benefits of FHLBank Membership Are Not Conferred to Idle Members</u>

The proposed rules appear to be concerned with the risk that insurance companies are on the membership roll of the FHLBanks currently and should either be removed from membership or compelled to adjust their portfolios of holdings substantially to retain membership and to maintain these holdings at all times. As there are no benefits conferred to members which are not currently utilizing FHLBank advances, the concern is misplaced. For an insurance company member to obtain the benefits of system membership, the following must occur under the existing regulatory framework: (1) the insurance company must be well capitalized; (2) the insurer must purchase FHLBank stock in the amount of 5% of its advances; (3) the insurer must have a home financing policy; (4) upon taking an advance, the insurer must hold additional capital under state law; (5) the insurer must see an economic opportunity to deploy FHLB advances received in a manner which is prudent and which earns a return to the additional capital required to support the advance.

Only after fulfilling these requirements—call them "utilization requirements" which are both regulatory and commercially based-- can members promote the mission of the FHLBanks. Insurance members which currently have little advance activity should not be put through the onerous step of reapplying for admission when market conditions do not warrant taking advances, or when capital is too expensive to support such advances.

In summary, membership regulation and utilization regulation should be logically distinct and not overlap. Imposing utilization type regulations to regulate membership for insurer members will simply have the effect of further discouraging membership and subsequent utilization of FHLBanks by insurers. As there is no benefit to idle membership, the decrease in utilization has no benefit but only cost—it reduces the amount of capital available to promote the mission of the FHLBanks.

3. <u>The Mission of the FHLBanks is Furthered by Utilization Activity Not Mere Membership Requirements</u>

The current regulations are more than adequate to assure members fulfill their obligations in promoting the mission of the FHLBank system. Correctly so, these regulations are focused on members' utilization of the system rather than on membership requirements. For example, the aim of the system is to promote home finance and community economic activity related to real estate. As residential home finance is deemed to be the more important aim, the current rules reflect this system objective. In particular, the current regulations state that advances over 5 years to support non-residential activity cannot exceed the amount of residential mortgage assets owned by a member. These types of utilization regulations are targeted, well-defined, and are applied equally to both depository and insurance company members. Since it can be easily demonstrated that membership as a statistic is not a relevant metric as to the FHLBank system's fulfillment of the mission, there is no reason in logic or fact for the ANPR to front load the burdens of utilization rules to the membership stage, particularly when the Home Loan Act provides no statutory authority for the proposed change.

4. <u>Insurers Are Already Subject to Differentially Harsher Treatment by FHLBanks</u>

Insurance companies are not FDIC insured institutions. Should an insurer become insolvent, the FHLB bank is secured by collateral, additional over-collateralization, FHLB bank preferred stock, policyholder level seniority, and remaining equity in the member. When a commercial bank goes insolvent, any outstanding advances at FHLBanks are quickly satisfied by the FDIC. Because FHLBanks do not have the FDIC "safety net" when making secured advanced to insurers, the member FHLB banks have treated insurance companies more harshly by imposing more onerous credit and collateral terms and denying business opportunities to insurance companies that would be readily approved for bank members, even where such opportunities involve much less risk than the business conducted by bank members. In essence, the "FDIC safety net" or put option has created perverse incentives within the FHLBank system whereby insurers have become second-class citizens and must fight for every business initiative to further the aims of the bank.

Guggenheim therefore opposes a further enshrining of anti-insurance company policy by introducing new regulations which further constrain insurer membership. Current regulations and FHLBank practices are already targeting insurance companies and deterring utilization. We see no benefit in additional rules which make membership and utilization even more difficult for insurer members, particularly when these members have a record of sound and prudent lending far exceeding the track record of insured depository members during the recent recession.

5. <u>Captive Insurance Companies Should Not be Subject to Special Rules for Membership</u>

We believe the ANPR does not have an adequate understanding of the legitimate uses of captive insurance companies. Captives have many uses and insure many risks. Captives are regulated under state law like any other insurance company.

In addition, to obtain qualification under federal tax laws, captives must bear a substantial amount of risk which is unrelated to the captive's parent company. Some of the largest Fortune 100 companies have captives. In addition, many life companies have insurance company subsidiaries which could be called "captives" but are no different from any other state regulated life company. These companies are used to manage special reserve obligations, such as those imposed by Regulation XXX under state law, and for many other purposes.

Guggenheim respectfully questions the ANPR's targeting of captives and "shell" companies. We surmise from the ANPR position a view that such companies are obtaining ill-deserved membership and then are somehow obtaining membership benefits while not promoting the core mission and values of the FHLBanks. As discussed above, we do not think there is any basis in logic or fact for this view. Captives are regulated insurance companies like any other. They are heterogeneous in mission and financial structure. They serve important roles in our economy. And, as discussed above, should a captive utilize the FHLBank system through advance activity it must first hurdle many onerous regulatory and commercial steps. If successful, utilization by definition serves the mission of the FHLBanks.

We respectfully request the ANPR be withdrawn at this time. We believe implementation of the types of rules discussed in the ANPR would have the unintended consequence of reducing capital formation for home finance, without achieving any benefits. Because we also believe there is no statutory authority for many of the ANPR's proposed rules, Congress should hear testimony to examine the factual and logical assumptions underpinning the ANPR before such major changes are made to a system which, in the case of insurers, has performed so admirably over the last 80 years.

Thank you for considering these comments.

Sincerely,

Jeffrey Lange
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Guggenheim Partners
Lecturer in Law (Insurance Regulation), University of Chicago