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FHFA Proposal Threatens Banks' Membership in FHLBanks

By Keith Thornburg, MBA General Counsel

The Federal Housing Finance Agency (FHFA) has published a proposed rule that could fundamentally change how -- or even whether -- a depository financial institution can remain a member of its Federal Home Loan Bank (FHLBank). Published in the Federal Register on September 12, the FHFA's proposal alters membership rules that have been in place for decades. Comments are due November 12.

The last significant congressional action on membership rules was in 1989. When congress has since adjusted membership requirements in 1998 and 2008 it was to expand membership opportunities. In this case the FHFA is acting on its own accord to place both restrictions and new burdens on membership requirements.

The threat is so great to community lenders' access to the low-cost funding available from the 12 regional wholesale banks, some in the industry have taken to calling the FHFA's proposal the "anti-liquidity regulation". During the deepest and free-falling periods of the financial crises the performance of the FHLBanks in providing liquidity to community banks was timely and effective. The FHLBanks were our "first responders" and provided many banks and many communities the "lifebuoy" that sustained them. The FHLBanks and their members proved seaworthy even as other federal agencies struggled to find their footing. The FHFA proposal pad-locks the lifebuoy and hides the keys.

Under existing law a bank qualifies for membership at the time of the bank's admission. The proposal imposes, for the first time, on-going mortgage asset test requirements. The new on-going tests would be a required 1% ratio of "home mortgage loans" to total assets and a 10% ratio of "residential mortgage loans" to total assets. Members failing these tests would be punished by having their FHLBank membership terminated. This is an extreme action, especially since a terminated or withdrawing bank cannot seek readmission for a period of five years.

Banks continually adjust their business plans to the market and the needs of their community. This is the basis that properly shapes a bank's loan and investment portfolio and this is what builds strong banks and strong communities. Under the FHFA proposal banks that want to maintain access to the liquidity available through membership in their FHLBank will have to adjust their business plans by misallocating their assets and capital merely to meet the requirements of an arbitrary regulation. The board and management will be compelled to operate their bank in a manner that is less responsive to their community and less profitable for their shareholders and in a manner that weakens the bank's capital and earnings. There will be an ongoing regulatory burden and expense to monitor compliance and in responding to regulatory reviews monitoring and determining compliance. Banks falling out of compliance will be subjected to corrective action plans.

When this proposal was published in an Advanced Notice of Proposed Rulemaking the response and comments were overwhelmingly opposed. The wisdom in the statement "If it ain't broke don't fix it" has never been more appropriate. We know that every regulation comes with side-effects and unintended consequences. Yet, the FHFA has summarily discounted all concerns to "fix" something that works. The risky action of the FHFA is untenable.

The proposal would have an especially adverse impact on community banks. It removes the certainty that the FHLBanks will be there as a reliable source of liquidity for their members in all market conditions.

The FHFA has invited comments on the proposed regulation. The comment period closes on November 12, 2014. Those interested in commenting can write: Alfred M. Pollard, General Counsel, Attention Comments/RIN 2590-AA39, Federal Housing Finance Agency, 400 Seventh Street SW., Eighth Floor, Washington, DC 20024. Comments can also be sent to the FHFA at: *www.fhfa.gov/open-for-comment-or-input.* The reference number to include in your subject line for the proposal is RIN 2590-AA39. The comment deadline is November 12, 2014.

For more information, contact Curt Heidt, FHLBank of Des Moines at (515) 281-1175, cheidt@fhlbdm.com. Follow developments on the issue on Twitter by using the hashtag #liquiditybuildscommunities.