FEDERAL HOME LOAN BANK OF CINCINNATI

October 31, 2014

Alfred M. Pollard, General Counsel
Attention: Comments/RIN 2590-AA39
Federal Housing Finance Agency
400 Seventh Street SW, Eighth Floor
Washington, D.C. 20024

RE: Notice of Proposed Rulemaking, request for comments: Members of Federal Home Loan Banks

Dear Mr. Pollard:

Thank you for the opportunity to respond to the Federal Housing Finance Agency (FHFA) notice of proposed rulemaking regarding revised membership regulations. On behalf of the Board of Directors of the Federal Home Loan Bank of Cincinnati (Bank), we are particularly grateful the FHFA extended the comment period in light of the fundamental membership changes proposed.

We appreciate the FHFA's intent to ensure that the benefits of Federal Home Loan Bank System (FHLBank) membership are being used to further the statutory mission of the FHLBank; however, we disagree that the proposed threshold tests for members and the ban on certain insurance companies achieves that outcome. To the contrary, we are concerned that these new membership rules, as proposed, would undercut the FHLBanks' mission of providing a reliable source of housing finance to its members and unnecessarily prevent new, private capital from supporting the housing finance market.

Proposal Does Not Address a Compelling Problem.

The proposed regulation to require ongoing membership eligibility requirements fundamentally changes the long-standing membership model. The FHFA notes that its proposal is needed because an applicant *could* cease making home mortgage loans after it becomes a FHLBank member. However, the FHFA reports that relatively few members would be harmed by the regulator's intent to sustain quantitative levels and, moreover, concedes it has found no evidence of a widespread problem of such conduct. Rather, the new rule would be adopted to correct "...the *possibility* (emphasis added) that institutions having no significant past or future involvement in home mortgage lending may become and remain Bank members..." and enjoy the benefits of membership, namely "...favorably priced funding through advances."

While few of the over 700 members in our Fifth District of Kentucky, Ohio and Tennessee would fall below the new ongoing mortgage-to-assets ratio tests, we believe the resulting additional burdens of continual compliance will have far-reaching adverse effects on many of our members. The one or 10 percent ratio requirement will encourage members to artificially manage their balance sheets during annual year-end reviews, rather than meet their customers' needs as they arise. The FHLBank cooperative structure does not demand that members engage in home mortgage lending 365 days per year. The Bank is not a lender of last resort, but rather a business partner with our members and the customers and communities they serve. We have historically appreciated that the respective needs of those customers and communities fluctuate over time. Under our 82-year old business model, every member must pledge adequate collateral, overwhelmingly comprised of residential housing related assets, in order to borrow Advances, thereby connecting the advantages of borrowing low-cost financing with mission-consistent activity.

We believe the current Advances business model ensures fulfillment of the FHLBanks' housing finance mission. Member institutions only borrow when they have mission-consistent assets to pledge as collateral, and therefore members only benefit from favorable pricing when engaged in mission related activity. This long-established nexus between housing finance and FHLBank membership benefits *already* addresses the FHFA's concern in the regulatory preamble that the new percentage tests "...ensure that benefits of membership, such as favorably priced funding through advances, accrue only to institutions that demonstrate a meaningful commitment to supporting residential housing finance..."

Membership Termination is a Harsh Penalty for Arbitrary Threshold Requirements.

If adopted as proposed, membership termination during any business cycle and any set of economic circumstances, because of the proposed percentage levels, is unjustly punitive to both the member and its customers. Risking an institution's membership cuts at the core of the FHLBank cooperative model. The FHLBank members benefit from and rely upon continued access to FHLBank Advances to secure consistent pricing, ready access to liquidity, and use of the shared Affordable Housing Program grant pool. Moreover, if enacted as proposed, the cure period preceding membership termination is inadequate. If a member is serving customers that are negatively affected by isolated variables such as natural disasters or pockets of economic stress, the average of two underperforming years with one year of recovery may not be sufficient to meet the required mortgage-to-assets ratio regardless of progress made in the third year.

The FHFA seeks comments regarding an increased standard for the one percent test, up to two or even five percent of long-term home mortgage loans held to total assets. Specifically, the FHFA asks what percentage between one and five could be established without either supplanting the "10 percent" requirement or unduly burdening a significant number of existing members? We believe this is the wrong line of inquiry and itself demonstrates the arbitrary nature of the percentage measurement. The better answer is found in the current Advances model, which connects members to mission, as discussed above.

Compliance Data Collection is Overly Burdensome.

FHFA states that it seeks to reduce the burden to FHLBanks as to collection of compliance data by requiring FHLBanks to use members' regulatory financial reports for the one percent and 10 percent ratio calculations. However, the FHFA concedes that none of the types of reports filed by FHLBank members (FFIEC, NCUA, NAIC reports) provides sufficient information to periodically determine the full amount of home mortgage loans or residential mortgage loans held by the reporting institution. The FHFA suggests that the FHLBanks look to one or more line items that include only assets that qualify for either the one or 10 percent test to show a measurement of "at least a portion of the qualifying assets" required.

We believe that the FHFA regulations, if adopted, should make clear that if a FHLBank member exceeds the partial listing, the reviewing FHLBank need look no further and that this measure should be sufficient for the "makes" test. Absent a specific formula from the FHFA, review of a member or applicant's three-year rolling history demonstrating some commitment to "makes long term mortgages" when combined with the existing FHLBank collateral requirements for Advances demonstrating a further nexus with mortgage related assets, certainly should meet the FHFA's stated goal to "...better ensure that the Banks fulfill their housing finance mission."

However, if adopted as presented, we would request a meaningful phase-in period for data collection and compliance, subject to the limitations on available financial reports as mentioned above.

Insurance Company Membership is Defined in FHLBank Act.

The original FHLBank Act specifically permits insurance companies to be members of the FHLBank System. Further, the Act makes no distinction and demonstrates no preference among the different *types* of insurance companies. Our Bank currently has life, property and casualty, health and title insurers as members. We believe captive insurance companies by virtue of being granted an insurance license by its respective state department of insurance, by itself, satisfies the Act's definition of an "insurance company."

In preventing captive insurance companies which are otherwise eligible members from joining the FHLBanks, the FHFA is assuming Congressional intent that runs counter to the prior actions of Congress meant clearly to *expand* membership. Congress acted in 1989 to include commercial banks and credit unions as members, in 1999 to support members' economic development activity by expanding eligible collateral (to include, for example, agri-business loans for rural lenders), and in 2008 to include community development financial institutions (CDFIs) as members.

The proposed FHFA regulations will clearly restrict the flow of private capital, supported by housing-related assets, into the recovering housing industry. By these regulations, the FHFA is determining which entities may or may not join the FHLBank System within a permissible class of otherwise statutorily eligible members not restricted by the Act or unclear under its provisions. Although our Bank does not currently have captive insurance company members, it supports the evolution of private capital into the housing market and has already demonstrated the System's long-standing ability to safely make Advances to non-federally insured financial institutions supported by mission-consistent collateral.

Redefined Principal Place of Business is Not Necessary.

The regulation also provides guidance on determining the appropriate FHLBank district for membership and the designation of its principal place of business (PPOB), primarily to clarify prospective insurance and CDFI memberships. While we agree and appreciate that any changes to or interpretation of this determination apply only to prospective membership applicants, we believe the better approach is to apply the same PPOB standard to insurance companies, commercial banks, savings banks and credit unions.

Prior to the FHFA 2012 regulatory interpretation (2012 RI) initiated by an inquiry for a CDFI membership designation, a FHLBank applicant's PPOB was defined as the "state in which the institution maintains its home office established as such in conformity with the laws under which the institution is organized." 12 C.F.R. §1263.18(b). This regulatory state of domicile was a first-default standard, but one which further permits an applicant for membership to request designation of a different state as its PPOB provided the applicant satisfies three factors related to the institution's business activities. Application of this regulation to insurance companies makes sense not only because many state insurance company statues require insurance companies to maintain a statutory "home office" in the state of domicile but, more importantly, the state of domicile is the state whose laws govern the rights of secured creditors such as the FHLBanks. Like any other type of institution eligible for membership, under these regulations, an insurance company could choose to request designation of another state as its PPOB if the three-factor business activity test was met.

The Bank's experience is that the vast majority of insurance company members meet *both* the state of domicile *and* the three-factor business activity test. In the rare case where the three-factor test was invoked, the outcome worked as designed. The pre-2012 RI rule is clear and should apply to all FHLBank member applicants, with possible exceptions for CDFIs, where the state of incorporation does not significantly affect the rights of secured creditors, or in the event of a jurisdictional dispute within the FHLBank System. In all other cases, we believe the determination for prospective FHLBank members should start with the statutorily-required first-default state of domicile standard, and permit the three-factor test to remain a secondary alternative.

Conclusion.

For the reasons discussed above, we believe that each of the proposed FHFA membership revisions -- and certainly all of them taken in their entirety-- would add unnecessary and adverse uncertainty to FHLBank membership and the System's housing finance mission be it through (a) ongoing and continual percentage tests, (b) concern that a particular charter type might be banned, or (c) lack of clarity regarding which District a prospective member may join.

We thus respectfully ask you to reconsider this set of proposals or, in the alternative, further open the discussion to public debate.

Sincerely,

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