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Via e-mail: RegComments@fhfa.gov

November 24, 2014

Mr. Melvin Watt
Director
Federal Housing Finance Agency
400 Seventh Street S.W., Eighth Floor
Washington, D.C. 20024

Mr. Alfred Pollard
General Counsel
Federal Housing Finance Agency
400 Seventh Street S.W., Eighth Floor
Washington, D.C. 20024

Re: Regulatory Information Number (RIN), 2590-AA39, Notice of Proposed Rulemaking; Request for Comments Involving Proposed Changes to the Regulations Concerning Federal Home Loan Bank Membership

Dear Messrs. Watt and Pollard,

This letter is being submitted on behalf of Five Oaks Insurance LLC ("FOI") in response to the Notice of Proposed Rulemaking; Request for Comments (RIN 2590-AA39) (the "Proposing Release") released by the Federal Housing Finance Agency (the "FHFA"). We refer herein to the FHFA's commentary in the Proposing Release as the "Proposing Release" and the text of the proposed rule contained in the Proposing Release as the "Proposed Rule." In the Proposing Release, the FHFA is proposing to substantially revise its regulations concerning membership eligibility in the Federal Home Loan Banks (the "FHLBanks").

FOI is submitting this comment letter because, if finalized, the Proposing Release would adversely impact FOI, the mission of the FHLBanks to support residential housing finance, FOI's participation in the capital markets to provide private capital for the purchase and securitization of residential loans, and FOI's ability to utilize the stable source of long term financing available to members of the FHLBanks. In addition, FOI also believes that the Proposing Release, from an administrative law perspective, exceeds the FHFA's authority to interpret and implement the Federal Home Loan Bank Act (the "FHLBA"). In addition, the Proposed Rule is an arbitrary and capricious exercise of the FHFA's regulatory discretion because it fails to adequately address the costs that captive insurance companies such as FOI, and other members of the FHLBanks and the residential mortgage market will sustain as a result of increased borrowing costs caused by the proposed membership limitations. Furthermore, FOI believes that the Proposed Rule, if adopted, would eliminate membership in the FHLBanks by captive insurance companies such as FOI, and by so doing, impede the ability each of the FHLBanks to perform their mission to support liquidity for residential mortgages.

Background and Current Position of FOI.

FOI is duly organized as a Michigan limited liability company and is in good standing with the Michigan Department of Licensing and Regulatory Affairs. Effective June 12, 2014, FOI was licensed by the Michigan Department of Insurance and Financial Services as a pure captive insurance company pursuant to Chapter 46 of the Michigan Insurance Code of 1956, as amended, MCL 500.4601 et seq. FOI is a wholly owned subsidiary of Five Oaks Investment Corp. ("FOIC"), a New York Stock Exchange listed real estate investment trust that focuses its entire investment portfolio on the residential mortgage market. In particular, FOIC participates in the residential mortgage market by investing in single family and multifamily mortgage loans, in the form of agency and non-agency mortgage backed securities, and by investing in residential whole loans. Recently, FOIC participated in its first securitization transaction involving the sale of a portion of FOIC's residential whole loans, the issuance of private residential mortgage backed securities, and the purchase by FOIC of the most subordinate portion (typically, 8-12%) of the securities created in the transaction which effectively represents our capital investment in such pool of residential mortgages. FOIC is committed to the purchase, securitization and investment in residential mortgages. FOI was formed, initially capitalized and licensed with the intention to participate in and the support of the U.S. residential mortgage market through investments in residential mortgage backed securities, multifamily mortgage backed securities and residential whole loans. Upon receipt of its license to operate as a pure captive, FOI submitted an application for membership with the Federal Home Loan Bank of Indianapolis (the "FHLBI") on June 16, 2014. FOI, as a pure captive insurance company, intends to provide insurance solely to its corporate parent, FOIC.

As a result of (i) the 90-day membership moratorium self-imposed on June 12, 2014 by each of the Federal Home Loan Banks regarding the admission of new captive insurance company members, and (ii) the issuance of the Proposing Release on September 2, 2014, the review and processing of FOI's application by the FHLBI has been unduly delayed.[1] FOI has been harmed by the moratorium and the Proposed Rule excluding FHLBank captive members. FOI is currently continuing to pursue FHLBI membership and believes that its application is complete and its proposed business is consistent with both the intent of the FHLB Act and the mission of the FHLBank and that its application for membership in FHLBI should be approved immediately.

As a member of FHLBI, FOI would be subject to the credit policy and overcollateralization requirements imposed on any other insurance company member of the FHLBI. In particular, in order to utilize the financing options available to members of FHLBI, FOI would be required to deliver collateral such as residential mortgages and mortgage backed securities in accordance with FHLBI's credit policy. Only when any such collateral has been delivered to FHLBI or its custodian would FOI be eligible to seek to draw on the financing

[1] Specifically with respect to the undue delay, FOI understands that a 60-day review and processing period had typically applied to FHLBI membership applications. Also, based on the similarities between FOI's operations and those of other entities admitted as captive insurance company members of the FHLBI, FOI believes that but for the moratorium, FOI would have been admitted as a member of the FHLBI prior to the date the Proposed Rule was published. Thus, as a result of this delay, FOI has been significantly disadvantaged.

alternatives available to FHLBI members. In order for FOI to deliver such collateral to FHLBI, FOIC would need to contribute that collateral to FOI, and any borrowing of FOI from FHLBI would be subject to the ongoing credit compliance and monitoring of FHLBI, including applicable "mark to market" provisions and requests, if applicable, for additional collateral based upon any changes in the value of the pledge collateral. FOI believes that the financing options available for FHLBI are attractive, not based on rate, but rather based upon the flexibility in term which would provide FOI with the opportunity to better match the maturity of its long-term residential mortgage investments with the maturity of the FHLBI borrowings. In turn, the participation of an insurance captive member such as FOI in FHLBI will help expand the membership of FHLBI, increase FHLBI's assets, and enable FHLBI to provide better financing terms to all of its members based on the increased level of assets. Thus, the participation by captive insurance members in the FHLBanks will enable the FHLBanks to grow and further expand their support of the mission of the FHLBanks.

FHFA Objection to Captive Insurance Company Membership.

In reviewing the Proposing Release, it appears that the FHFA's two primary reasons for excluding captive insurance companies from membership in FHLBanks are supervisory concerns and safety and soundness concerns.

Supervisory Concerns. With respect to the supervisory concerns, the FHFA suggests in the Proposing Release that captive insurance company members should be excluded because they are being used as a "conduit" to access FHLBanks borrowing for otherwise ineligible entities. Furthermore, the FHFA notes that because captive insurance companies generally did not exist when the FHLBA was passed, it could not have been Congress' intent to include them in the scope of eligible insurance companies.

The FHLBA, its legislative history and most of the commentary surrounding its enactment clearly establishes that the intent of the law is to enhance liquidity in the U.S. residential mortgage market by providing FHLBank members with access to low-cost, favorable term borrowing on an (over) collateralized basis. Specifically, in statements surrounding the signing of the FHLBA, President Hoover indicated that the purpose of the Act and the creation of the FHLBanks were to alleviate the housing finance crisis that existed during and as a result of the Great Depression and to ensure the ongoing accessibility of home ownership on favorable terms. Accordingly, when interpreting the FHLBA and adopting rules and regulations, the first and foremost question that the FHFA must address is "what impact does this interpretation, rule or regulation have on advancing the purpose of the FHLBA and the mission of the FHLBanks to provide liquidity to the U.S. residential mortgage market?" Although in the Proposing Release the FHFA seems to be conceptually concerned with what it generalizes as the improper motivation, ownership and operations of all captive insurance companies, the FHFA does not provide any empirical analysis or information about the actual or projected, immediate or future impact that precluding captive insurance companies from becoming FHLB members will have on the U.S. residential mortgage market, the availability of residential mortgage loans or the rates payable by the residential mortgage loan borrowers. Also missing from the Proposing Release is any analysis about the potential financial impact to the FHLBs and their members if captives are precluded from joining and current members are phased out. Even though there are

only approximately 20 current captive insurance company members of FHLBanks, the Proposing Release does not address the amount of the outstanding advances to such members. FOI believes that the activity and advances of these captive insurance company members are increasing and represent a material portion of the borrowing activity of certain FHLBs. The Proposing Release does not address this fact or the impact on the FHLBanks and their other members as a result of such activity for the FHLBanks.

Although the Great Depression is a matter of distant history, the Great Recession is fresh in everyone's mind and the U.S. residential mortgage market is still in a very fragile state. As a result, in order to ensure the intent of the FHLBA is upheld and to prevent another (or ongoing) mortgage credit crisis, it is imperative that the FHFA evaluate and understand the financial impact of the Proposed Rule, whether it pertains to excluding captive insurance companies or otherwise. Because such financial impact is of paramount importance to U.S. citizens and taxpayers, it should be clearly analyzed in connection with the Proposed Rule to facilitate the most informed comments and insightful dialogue. On this point, unlike the FHFA, FOI does not have access to the detailed financial information of the FHLBanks (*e.g.*, the current borrowings of captive insurance company members). However, because FOI understands that there are a number of similarly situated captive insurance companies that are active or prospective members of the FHLBanks, FOI believes that the financial impact on the U.S. mortgage market and the FHLBanks would be significant. In particular, unlike many other FHLB member entities like depository institutions or traditional insurance companies that hold varying portions of their assets in U.S. mortgage-related collateral, FOI's projected balance sheet will consist entirely of residential mortgage backed securities, multifamily mortgage backed securities and residential whole loans. As a result, FOI's investments and activities, like those of many of the other captive insurance companies seeking FHLBanks membership, are entirely and emphatically consistent with the intent of the FHLBA and the mission of the FHLBanks. Rather than raising a question of supervising concerns, captive insurance company membership, in realty, would be fulfilling the mission of the FHLBA and should be analyzed from that content.

On the issue of congressional intent, it is important to note that the FHFA's argument for excluding captive insurance companies because the concept of captive insurance was not in existence when the FHLBA was passed flies in the face of traditional statutory interpretation principles. If it were necessary to demonstrate that Congress contemplated a specific context or application of a law, then the legislative branch of our government would be in an ever-present state of updating laws in order to address continuing innovations and developments occurring on a daily basis in the U.S. Rather than delving into a conceptual state of eternal inefficiencies regarding legislative actions, it should instead be recognized that the FHLBA was written to achieve the particular result of enhancing liquidity in the U.S. mortgage market. Specifically, the membership eligibility provisions of the FHLBA are very broad and apply to "*any* . . . insurance company," clearly indicating that the specific type and activities of the insurance company do not matter as long as the company (i) is duly organized under the laws of any state, (ii) is subject to inspection and regulation, and (iii) makes long term home mortgage loans (which includes holding interests in assets securitized by such loans). Presumably, Congress was aware of its ability to define "insurance company" and other eligible entities under the FHLBA. Furthermore, in 1932, life insurers were the primary insurance companies engaged in the

business of providing or investing in mortgage loans. The fact Congress elected not to further define the term "insurance company" or specify life insurance companies as the only eligible members of FHLBanks, and instead included the term "*any insurance company*" as an eligible FHLBank member establishes Congress' intent for FHLBank membership eligibility to be construed as broadly as possible to support the purpose of the FHLBA and the mission of the FHLBanks. Defining the term "insurance company" in the manner suggested in the Proposed Rule to exclude certain entities that are organized, licensed and regulated as insurance companies is not, as the Proposing Release suggests, within the scope of the FHFA's rulemaking authority. Instead, it directly conflicts with the clear and unambiguous text of the FHLBA, which can only be amended through congressional action. Taking the logic presented by the FHFA in the Proposing Release to an extreme, mortgage backed securities ("MBS") and collateralized mortgage obligations ("CMOs") would not satisfy the original intent of Congress in the FHLBA because such investments did not exist at the time of the enactment of the FHLBA. MBS and CMOs represent an evolution in "long term mortgages", and apparently, have been recognized and embraced by the FHFA and the FHLBanks. Insofar as the category of assets that qualify as "long term mortgages" has been expanded by the FHFA it does not make sense for the FHFA to so restrict the definition of "insurance company".

In addition to conflicting with the text and intent of the FHLBA and the mission of the FHLBank, the stated purpose of the Proposing Release to exclude captive insurance companies as eligible FHLBank members is inconsistent with current legislative and regulatory efforts concerning the U.S. mortgage market. In particular, one of the stated goals of recent government-sponsored entity ("GSE") reform efforts is to bring private, at-risk capital back into the U.S. mortgage market. With Fannie Mae and Freddie Mac still in conservatorship, Federal government guaranteeing or insuring over 80% of all new mortgages, and the Federal Reserve's bloated balance sheet as a result of the various rounds of "quantitative easing," it is clear that all is not well with the U.S. mortgage market. While seven years have elapsed since the mortgage crisis began, government intervention and U.S. taxpayer exposure to the mortgage market remains at an all-time high. In order for the Federal government to retreat from its current dominant position in the mortgage market without creating disruption, a major infusion of private, at-risk capital, such as that provided by captive insurance members such as FOI, will be required. FOI believes that allowing captive insurance companies that support the mission of the FHLBanks by providing or investing in residential mortgage assets to become members of the FHLBanks is a way for the Federal government to facilitate the much needed infusion of private, at-risk capital into the residential mortgage market.

However, rather than focusing on and analyzing the tangible benefits of captive insurance company membership, in the Proposing Release the FHFA has instead highlighted the conceptual and superficial concerns regarding the entities serving as a "conduit" for financing activities of non-eligible entities, such as real estate investment trusts. To this concern, there are two appropriate questions for the FHFA: 1) even assuming the "conduit" characterization is correct (which FOI does not for the reasons stated below), what difference does it make if the captive insurance company serves as a conduit for promoting residential mortgage finance if the result is the facilitation of U.S. mortgage origination and investment activities that are consistent with the FHLBA and the mission of the FHLBanks?; and 2) insofar as money is fungible, how

and to what extent does the FHFA know what is done with the FHLBank borrowings of any FHLBank member financial institution, life insurance company, captive insurance company or otherwise? That is, related to both of these questions, if a life insurance company or a financial institution utilizes FHLBank advances to buy mortgages from an originator, then it would seem that the same "conduit"-type logic presented in the Proposing Release would apply because the originator (an ineligible entity) is gaining access to FHLBanks advance funds through the eligible entity's purchase of the loan. Similarly, insurance company and financial institution members of FHLBanks may be subsidiaries of a bank or insurance holding company, and 100% owned by such holding company. Would the activities of those members not raise similar issues of acting for the benefit of a corporate parent that is raised in the Proposing Release? However, it should be noted that (i) a captive insurance company member does not necessarily transfer (through eligible asset purchases or loans) the funds advanced from an FHLBank to the captive's parent and instead, uses such funds for its own operational and investment activities, and (ii) concentration of assets on the captive insurance company's balance sheet that are eligible for pledge to the FHLBanks should not cause any conceptual or supervisory concern to the FHFA insofar as such concentration pertains almost exclusively to the support of the FHLBanks' mission and is subject to the FHLBank credit policy and overcollateralization requirements applicable to such member.

As a final point regarding the supervisory concerns noted in the Proposing Release, the FHFA's willingness to delve into the state-regulated field of insurance for purposes of discussing captive insurance companies and defining "insurance company" is of particular concern to FOI. Underlying the delegation of insurance regulation to each individual state in the McCarran–Ferguson Act is the emphasis on the need for there to be clear direction regarding the responsibility for the oversight of the business of insurance from experienced regulators that understand the applicable laws and the activities of insurance companies. The FHLBA contains no such distinction of different categories of insurance company members, and the FHFA's attempt in the Proposed Rule to distinguish among newly created categories of insurance company members or any other class of members is completely without statutory basis.

Safety and Soundness

Turning to the "safety and soundness" concerns raised by the FHFA in the Proposing Release, it is important to note that unlike Fannie Mae and Freddie Mac, in over 80 years of existence, the FHLBanks have never sustained a systemic loss resulting in the need for government intervention or taxpayer exposure. Presumably, this result is a testament to the FHLBanks and their credit processes, procedures and compliance controls in place to protect against the credit risk of member borrowings, regardless of whether the member is an insurance company, bank, credit union, etc.[2] Captive insurance company members, and every other member are required to transfer or pledge to the FHLBanks sufficient collateral in excess of the borrowings. If FHLBanks advances are provided to captive insurance company members on an

[2] On this point, it is FOI's understanding that although there generally are three categories related to the method of pledging collateral to the FHLBanks (*i.e.*, blanket lien status, listing status, and delivery status), the delivery status method is most frequently utilized for collateral pledged by insurance companies. This method, and specifically the physical possession of the assets, provides the FHLBanks with even more protection against credit risk.

over-collateralized basis and the FHLBank credit and collateral policies and procedures are consistently applied, then it is unclear how or why captive insurance company members would present any greater credit risk to the FHLBanks and thus implicate any safety and soundness concerns whatsoever. In FOI's case, the Michigan insurance statutes have been revised to clarify that FHLBI would be able to realize on its collateral in priority of other creditors. The only possible explanation for the FHFA's concerns referenced in the Proposing Release is that captive insurance companies lack a Federal or state-sponsored backstop or insurance fund (*e.g.*, the FDIC, NCUA, etc.) in the event of insolvency. If the insurance company captives are providing insurance, as suggested in the Proposing Release and as anticipated by FOI, solely to their parent, there is no such backup or extra coverage needed. Further, community development financial institution ("CDFI") members share this same risk of not having another state or federal financial backstop and yet their continuing membership/unique credit risk is not being questioned in the Proposing Release. More importantly, if the goal of GSE reform is to reduce government involvement and taxpayer risk in the U.S. mortgage market, then emphasizing the reliance or requirement of industry or taxpayer-sponsored guaranty backstops as a positive credit factor in excluding captive insurance companies as members does not appear to be advancing that goal.

Nowhere in the Proposing Release does the FHFA provide any evidence to support its claim that captive insurance companies pose a greater credit/default risk than other FHLBank members, including traditional insurance companies. Industry data demonstrates that captive insurance companies fail at a much lower rate, proportionally, than other "traditional insurers". The explanation for the lower failure rate is actually one of the reasons cited by the FHFA as a potential concern in the discussion in the Proposing Release of the alignment of interests between the captive insurance company and its corporate parent. Because FOI and many other captive insurance companies primarily insure the risks attributable to their owners, the owner-insureds have a vested interested in ensuring the ongoing solvency and financial strength of the captive insurance company. If an insurance company captive becomes insolvent, then the owners potentially lose both their insurance coverage (*i.e.*, they become uninsured or self-insured and directly responsible for paying loses) and their investment in the captive. While captives generally have a lower default rate than traditional insurers, it is FOI's understanding from discussions with insurance managers and insurance regulators that the default of single parent captive insurance companies is even more rare. Most FHLBank insurance company captives, including FOI, are formed as single parent, pure captives and the insurance risk is fully funded in its capital. As a result, the likelihood that an FHLBank insurance company captive member would experience a default in connection with its insurance program is almost non-existent. Therefore, unlike any other eligible FHLBank members, the credit risk of captive insurance company members would be almost exclusively tied to the underwriting of FHLBank-mission specific investments (which, as noted above, the FHLBanks have processes, credit policies and procedures and over-collateralization in place to protect against).

One of the most important factors which support the safety and soundness of captive insurance company members is that such members are subject to the same or similar regulatory framework as traditional insurance companies and, as a general matter, are subject to far more oversight and regulation than certain other members of the FHLBanks, including CDFIs. As part

of the regulatory framework in place in Michigan applicable to captive insurance companies such as FOI, the insurance company captive (i) must submit financial information (including, in most jurisdiction, audited financial statements and certifications from an actuary regarding the sufficiency of funding) to the state regulator at least annually, (ii) must maintain minimum capital and surplus to satisfy state law (net of the actuarially determined loss reserves), (iii) are prohibited from distributing assets from the captive to its owners without regulatory approval, (iv) must submit a business plan to the regulator, conduct business solely in accordance with such plan, and submit any proposed changes to its business plan to the regulator for approval, (v) must engage an independent auditor and independent insurance manager, and (vi) must generally have at least one independent manager/director serving on its board. If the ongoing solvency of a captive insurance company becomes a concern of the applicable insurance regulator, the regulator may intervene and such intervention can include actions such as requiring that the parent company contribute more capital, requiring the captive insurance company to charge higher premiums, requiring more frequent financial reports, or, in worst case, suspending the captive's license. As a result of the foregoing, contrary to the FHFA's suggestions in the Proposing Release, it is very unlikely that the captive would operate against its own self-interest or that its financial condition could deteriorate rapidly without the insurance regulators and the applicable FHLBank's knowledge. In addition, it is our understanding as a result of an informal survey that most, if not all, of the FHLBanks require the corporate holding company or parent to guarantee the advance obligations of captive or other insurance company members, and in such an event, the applicable FHLBank would be able to pursue remedies against both entities, captive insurance company and its parent rather than just the captive insurance company. Such rapid deterioration in the context of FHLBank captives insurance companies would be almost exclusively limited to a significant and severe decrease in the value of the member's investments, which ultimately should be protected by the credit policies, procedures of the FHLBank and the over-collateralization of the borrowings. In any event, the investment value risk ultimately faced by any FHLBank is not unique to a captive insurance company and is present in the risk of borrowings of all FHLBank members.

Furthermore, because the State insurance regulators regularly monitor the financial performance of captive insurance companies and because captive insurance companies are prohibited from transferring assets without the permission of their regulator, it is not possible for the captive insurance company to serve as a "conduit" to merely pass through the cash raised in connection with FHLBank borrowings. Furthermore, because the FHLBank advance constitutes a liability of the captive insurance company, the state regulators will not allow the captive insurance company to transfer the funds if doing so would result in an adverse financial position at the captive insurance company level. Therefore, FOI expects that its balance sheet presentation, and the precise transparency regarding the use and nature of the FHLBank advanced funds to facilitate liquidity and investments, is consistent with the goals and intended business of many other FHLBank members beyond the context of insurance company captives. As a result, the "conduit" characterization, and its use as a negative and pejorative connotation applicable to real estate investments trusts is improper and unsupported by any factual evidence presented in the Proposing Release.

Conclusion

In closing, captive insurance companies have been members of the FHLBanks for over 20 years. Additionally, FOI understands that there are approximately 20 current captive FHLB members, each of which was ostensibly reviewed by the FHFA in its supervisory role over each FHLBank. While it is unclear why the FHFA suddenly (after 20 years and multiple credit cycles without any captive specific issues) felt the need to exclude captive insurance companies from FHLBank membership, it is nevertheless important to recognize that captive insurance companies have historically played a role in supporting the mission of the FHLBanks, FOI intends to continue that tradition and seeks to expand that role in a safe and sound manner in the future. Accordingly, for the reasons stated herein and in other comments submitted, FOI respectfully requests that the FHFA refrain from implementing the provisions of the Proposed Rule while seeking to exclude captive insurance company membership of FHLBanks and approve FOI's pending application to FHLBI.

Sincerely,

David Carroll, President