December 4, 2014

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

Office of Information and Regulatory Affairs, OMB
Attention: Desk Officer for Federal Housing Finance Agency
Room 10102, New Executive Office Building
725 17th Street NW
Washington, DC 20503

Re: Members of the Federal Home Loan Banks
Notice of Proposed Rulemaking, RIN 2590-AA39 (NPR)

Dear Mr. Pollard and OMB Desk Officer:

We, the 17 Directors of the Board of the Federal Home Loan Bank of Indianapolis (FHLBI), are deeply concerned about the impact the proposed Federal Home Loan Bank (FHLB) Membership rule cited above will have on the ability of the bank we oversee to fulfill its mission to ensure that Michigan and Indiana financial institutions have reliable access to the liquidity needed to serve their communities.

**The FHLBI Board**

Together, we have more than 100 years of service on the FHLBI Board, and more than 500 years of post-graduate academic and professional experience pertinent to the active and successful oversight and management of a Federal Home Loan Bank. Our Board is comprised of professionals with remarkable depth and breadth of knowledge and experience:

- many of us are senior leaders of small- and medium-sized local/regional financial institutions that rely on access to FHLBI liquidity to serve our communities;

- others of us oversee local nonprofits that are committed to the bank's housing mission and understand the value and importance of FHLBI's grant programs to our region; and

- others amongst us have deep academic, practical and legal expertise in areas of crucial importance in terms of FHLBI's mission, including governance and oversight, multi-family real estate and community development lending.

Further, as you can see from our individual signature lines, we come from areas across Michigan and Indiana that feel the direct impact of the good work of FHLBI. As such, we understand that serving on the FHLBI Board is a serious responsibility, and we've made an important commitment to maintaining safe and accessible liquidity for the communities our members serve.

In short, our Board is a carefully structured oversight and governance body whose membership is validated through regular director elections. We are intimately aware of FHLBI's operations, its management team, and most importantly, its commitment to providing liquidity to financial institutions throughout Michigan and Indiana. We do a thorough and careful job of making sure the FHLBI and its management team are lending in a safe and secure manner.

Given the FHLBI Board's fiduciary duties to protect the bank and its members' interests, we're very concerned about several likely effects of the NPR on FHLBI's ability to serve its members.

**Impact on FHLBI Business Model, Operations and Ability to Deliver on Our Mission**

First and foremost, the proposed rule, if enacted, will negatively impact our bank's successful long-term business model, with the potential to reduce access to liquidity for Michigan and Indiana member financial institutions and the local communities they serve.

The rule will have a similar detrimental impact on the amount – and stability – of Affordable Housing Program (AHP) grant monies available for Indiana and Michigan projects. Recall that 10% of all FHLBank profits system-wide are returned, in grassroots style, to each district's area for housing development in the form of grants. Since AHP began in 1989, that amounts to just shy of $250 million in grant dollars invested in housing for those most in need in Michigan and Indiana. Curbing legitimate membership will only hurt the region we strive to serve.

Our bank has built its business based on the existing, well-established definition of bank membership eligibility. Over the last several years, we've seen profound growth in the number of insurance companies interested in becoming members. We've prudently, cautiously considered this influx of interest, because we carry on our shoulders a responsibility to all our members.

With our support and oversight, FHLBI management and staff have acquired significant insurance industry knowledge, expertise and experience. In particular, FHLBI has thoroughly developed its skills and expertise in insurance company lending to captive insurers doing business under Michigan's captive insurance law. As Directors we have also observed management's careful adherence to all Finance Agency pronouncements and guidance regarding lending to captive insurance companies and other insurers.

We are rightly proud of FHLBI's evolution to an active, vigilant and prudent lender to all of our insurance company members. Growing our insurance company membership has been the right thing to do in fulfillment of our mission because it keeps liquidity flowing in our two states, and the resulting profitability and stability has a positive and meaningful impact on our AHP participation.

Because depositories and insurance companies employ different business models, their funding needs and strategies are not very highly correlated. Therefore, safely and soundly lending to insurance companies, including captive insurers, results in a more diversified membership base, which brings stability to FHLBI's advances portfolio. Diversity of membership *within* the insurance sector is also important for FHLBI because it provides an additional layer of protection against economic volatility for the communities we serve.

The proposed changes to the longstanding rules of FHLBI membership will negatively impact our long-term business plans and limit our ability to consistently serve our membership and Michigan and Indiana households no matter what the economy brings.

## Captive insurance companies *are* insurance companies

Michigan is one of at least 37 U.S. states, districts and jurisdictions that have laws enabling the formation – and regulation – of captive insurance companies. The FHLBI Board fully supports allowing captive insurance companies to pursue FHLBank System membership. After all, they are insurance companies, which have been eligible – per Congressional design – for FHLBank membership since the FHLB Act became law in

1932. Further, in the case of captive insurers who have become duly vetted FHLBI members, they help to keep liquidity flowing in our region, and further the mission of the bank.

If the NPR is adopted as proposed, the existing memberships of healthy, sound and mission-oriented Michigan-based captive insurers will be terminated – and as a Board, frankly we're mystified as to why the Finance Agency wants that result. Nothing in the NPR explains why the Finance Agency views captive insurance companies' memberships as riskier than other insurance company members, or why existing regulations and recent guidance with respect to captive insurance company membership and advances are inadequate.

The fact is, Michigan's captive insurance companies face <u>the same rigorous regulatory oversight</u> as all other Michigan insurance companies:

- they face the same examination schedule as all other Michigan insurance companies;

- they are required to file annual financial reports that are reviewed in the same manner as those filed by all other Michigan insurance companies;

- they are subject to ongoing regulation and supervision through the Michigan Department of Insurance and Financial Services, just like all other Michigan insurance companies; and

- they are bound by the same rehabilitation/liquidation statutes as all other Michigan insurance companies.

Captive insurance companies in Michigan are held to the same high standards as every other Michigan insurance company admitted to FHLBI membership. Period.

We're also deeply concerned as a Board that this proposed rule will impose an arbitrary and stricter standard of membership on captive insurers based on their affiliation with businesses that are ineligible for FHLBI membership. This form of discrimination has no rational basis, since many bank members are owned by bank holding companies that are ineligible for membership and as such this has been a widely understood and accepted feature for many years.

We respectfully suggest that the determining factor for membership eligibility should be an insurance company's investments – its commitment to and support of the

FHLBanks' missions – not whether it writes certain kinds or sufficient amounts of insurance for unaffiliated companies. We know from our deep, long-time commitment and involvement that the Indianapolis FHLB carefully and thoroughly vets any and all potential new members on this standard.

In the end, the test for FHLBI membership eligibility of captive insurance companies should be no different than that imposed on any other eligible membership candidate, and it is quite a simple standard:

1) Does the applicant fit the mission-based membership requirements for the FHLBank?

2) Can the FHLBank establish appropriate policies, procedures and underwriting to support safe and sound lending to this applicant?

We remain confident the FHLBI's lending model for all of its members – including captive insurers – is robust and supports safe and sound lending by addressing these two concerns.

Further, we recommend that the Finance Agency let the state regulatory agencies continue to do what they do best – defining what constitutes an insurance company in their state and providing regulatory oversight of those companies. We know from experience that the states are fully capable of establishing and maintaining strong, effective regulatory oversight of captive insurers and do in fact fulfill those responsibilities.

**Principal Place of Business**

We also strongly disagree with the Finance Agency's opinion that the chosen state of domicile is an inappropriate basis for establishing an insurance company's "principal place of business" (PPB). From the perspectives of credit, safety, and soundness, our very real experience with FHLBI has shown us that an insurer's domicile is *the* most important factor in PPB, precisely because that is where the insurer's primary regulator – the state department of insurance – is located.

With all due respect to the role of the Finance Agency, it is the state insurance regulator that has the closest ongoing regulatory relationship – and therefore the deepest understanding – of the insurance company.

If an insurance company member fails, the regulator from the state in which the insurance company is domiciled will control the company's rehabilitation or liquidation proceeding, *regardless* of where the company writes its business, where its customers reside, where its highest-paid executives reside, or where its corporate headquarters may be located. Make no mistake about it: when an insurance company selects its domicile, it is choosing to identify that jurisdiction as an essential location of its business and is backing that choice with significant legal commitments.

Please, keep it simple: the PPB requirements for insurers, depositories and all other FHLBI members should be the same.

**Ongoing membership tests**

The FHLBI Board is also very troubled by the likely impact of the NPR's new ongoing membership tests, particularly as the reasoning behind and need for them is unclear.

First, these tests impose additional regulatory burdens on our members. Recall that most of our members are small- to medium-sized local and regional financial institutions with fewer than 100 employees – so this is indeed an incredibly burdensome and expensive proposition. The Finance Agency has a responsibility to make sure that these ongoing tests serve an important purpose before imposing them on FHLBI membership. In fact, there is no compelling reason for these new tests.

Second, if a member fails these ongoing tests and is disqualified from FHLBI membership, the biggest losers will be the individuals, families and small businesses served by that financial institution. In some areas of Michigan and Indiana, a sole FHLBI member is a community's only lifeline to capital investment. Constructing a rather arbitrary asset test from back offices in Washington D.C. seems like a dangerous and counterproductive approach to encouraging healthier funding streams to reach America's smallest towns and communities.

We know not only from our role as FHLBI Directors – but also from our own professional lives in the towns and cities of Michigan and Indiana – that our member financial institutions support housing finance in many ways, every day. In fact, the Indianapolis bank's collateral policies create incentives for our members to continually support mortgage finance and economic development.

And frankly, these ongoing tests fail to give appropriate recognition to institutions that provide residential mortgages to their customers, but then sell them into the secondary market as part of their business plan. It's simple: just because a mortgage is not on a member's books does not mean the member is not supporting mortgage finance in their community!

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If the proposed rule is adopted, the FHLBI will see negative effects to its membership base, and, in turn, its ability to provide mission-oriented support for our district's financial institutions and the households they serve.

Rather than being penalized for prudently meeting the evolving needs of modern housing finance, FHLBI should be lauded as a success story that has established a safe, secure and diversified business model while successfully embracing the FHLBank system's original intent. The bank has done a superb job of carefully protecting its members' assets while ensuring that more capital flows more easily throughout Indiana and Michigan.

Further, the proposal lacks supporting evidence that would make it clear *why* it is being instituted, *how* it would benefit the system or housing finance liquidity, and *what* benefits it provides given the current robustly defined structure of the system. In addition it lacks support by the banks in the system, most members, and many in Congress. It is simply without merit, given the stellar record of the FHLB system.

For these reasons, we the undersigned respectfully urge the Finance Agency to withdraw the NPR on FHLB membership. Thank you for your time and consideration.

Sincerely,

Directors of the Federal Home Loan Bank of Indianapolis

James D. MacPhee, Chair
CEO and Director
Kalamazoo County State Bank
Kalamazoo, Michigan

Michael J. Hannigan, Vice Chair
President
The Hannigan Company
Indianapolis, Indiana

Jonathan P. Bradford
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Christine Coady Narayanan
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