NCBANKERS
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December 19, 2014

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

Re: Notice of Rulemaking and Request for Comments – Members of Federal Home Loan Banks (RIN 2590-AA39)

Dear Mr. Pollard:

We appreciate the opportunity to comment on the Federal Housing Finance Agency's proposed rule RIN 2590-AA39 Members of the Federal Home Loan Banks. As a state trade organization representing over 105 federally insured banking institutions in North Carolina, many of which are FHLBank members, we appreciate your desire to ensure the FHLBanks remain focused on the housing portion of their mission. However, we believe the proposed rule directly conflicts with permissible uses of FHLBank advances as defined by Congress and undermines the valuable role the FHLBanks serve in supporting community financial institutions.

Over the past 25 years, Congress has broadened access to FHLBank funding and liquidity by expanding both membership eligibility and the ways in which member institutions can use advances. Since 1999, community financial institutions (CFIs) have been able to use long-term FHLBank advances for residential housing finance, small business loans, and small farm and small agri-business purposes. While we recognize the importance of a healthy housing finance system and the FHLBanks' statutory obligation to support housing finance, we assert that a commitment to housing finance is but one part of the modern mission given to the FHLBanks by Congress. We believe the proposed rule amends current law rather than establishing safety and soundness regulations to support the statute and FHLBank mission. We also believe that any changes to the statutorily established uses of FHLBank advances, in particular changes that would narrow the FHLBanks' mission as the proposed rule appears to do, should come from Congress first.

The changes listed below are items of concern to our members and we urge you to reconsider these changes.

The Proposed Rule's New Membership Requirements

The proposed rule would revise the FHLB membership rules in two fundamental ways. It would impose, for the first time in the history of the System, on-going mortgage asset tests – with different tests for members of different sizes, and would alter the definition of insurance company to exclude captive insurance companies from membership in the System.

Under the proposed rule all FHLB members would be required to hold, on an ongoing basis, one percent of assets in "home mortgage loans" as defined by the FHFA in order to satisfy the requirement that an institution make long term home mortgage loans. Further, all depository institutions that are not CFIs – defined by FHFA as depository institutions at or below $1.108 billion in assets – must also comply with an ongoing requirement that at least ten percent of their total assets are in "residential mortgage loans" as defined by FHFA. The current test to ensure that eligible members make home mortgage loans is a one-time test upon application for membership. A prospective member must demonstrate that it has such long-term mortgage assets on its books at the time of application but has never before in the history of the System been required to comply with an ongoing test. Under the proposed rule members found to be out of compliance (based on a rolling three year average) would be given one year to return to compliance. If the member remains out of compliance for two consecutive years, their membership would be terminated and would be cut off from all FHLB liquidity and services. Termination would mean being cut off from FHLBank sources of liquidity, letters of credit, mortgage purchase programs, affordable housing programs, and community investment products – some of the very activities the proposed rule is designed to enhance.

Additionally, captive insurance companies would be deemed ineligible for membership in the System and would be forced out of the System if the proposal were to take effect. The proposed rule would effectuate this change by redefining "insurance company" not to include captive insurers, even though the Federal Home Loan Bank Act – the authorizing statute – states that all insurance companies are eligible members.

The proposed rule runs counter to the clearly authorized mission activities of the System and to the plain meaning of the authorizing statute with regard to eligible members of the System.

Chartered by Congress in 1932 to provide liquidity for housing finance to what were then known as building and loan institutions (now savings associations) and insurance companies – the primary lenders for mortgage finance at the time, the scope of eligible membership in the System and the mission of the System have consistently been expanded by Congress in the intervening eighty two years. In 1989 membership was expanded by Congress to all federally insured depository institutions, including commercial banks and credit unions. In 1999 and in 2008 Congress expanded the categories of collateral eligible to be pledged by members for FHLB liquidity and in 2008 Congress formally recognized the FHLB's role in providing liquidity to their members without limiting that purpose to housing finance. Today, as the FHFA noted in the FHFA Strategic Plan: Fiscal Years 2015 – 2019, the Federal Home Loan Banks' "core mission is to serve as a reliable source of liquidity for their member institutions in support of housing finance and community lending."

In recent years, the FHFA has also acted to further authorize additional categories of collateral beyond those tied to housing finance, including federally insured student loans (authorized in 2009)

and loans made by Community Financial Institution members of the System for community development purposes in 2010.

These actions, both Congressional and regulatory, make clear that the mission of the FHLB System has been expanded beyond housing finance. Inexplicably, the FHFA has proposed this rule in an apparent attempt to reestablish a nexus between FHLB membership requirements and the mission of the System as established by Congress. However, the rule would have the effect of substantially limiting the mission of the FHLBanks in providing reliable liquidity to their members. By focusing membership requirements solely on residential mortgage loans and home mortgage loans, the rule ignores the many other categories of mission related assets a member may hold on its books.

As to the definition of insurance company, the authorizing statute is clear. All insurance companies are eligible for membership, just as all federally insured depository institutions are eligible. For the FHFA to decide on its own that it can redefine the meaning of "insurance company" to exclude captive insurers sets a dangerous precedent. FHFA could potentially determine that "federally insured depository" no longer has the same meaning for a commercial bank or a credit union as it does for other institutions.

The proposed rule is harmful to the Federal Home Loan Banks, their members and the communities they serve.

The proposed rule will make access to FHLBank liquidity far less certain. The imposition of on-going asset tests will result in member banks being unable to be certain of their future ability to meet the tests in all market conditions and maintain their membership and borrowing ability, especially in times of financial stress when asset values can erode rapidly. Uncertainty over the ability to borrow will harm the member bank's safety and soundness standing with their prudential regulator. Additionally, member banks will face reduced flexibility in balance sheet management as they strive to ensure they hold the required mortgage assets on their books, even if other financial regulators express concern over holding greater amounts of mortgage assets on balance sheets. These problems are likely to be especially acute for banks that are approaching the Community Financial Institution (CFI) asset cap. A CFI that exceeds that cap, either through growth or merger, would be required to meet the 10 percent residential mortgage test or lose their FHLB membership. Thus, as they grow, they will have to distort their balance sheet management or face uncertainty as to their continued ability to borrow from the System, or both. A CFI that acquires another bank with fewer mortgage assets could fail the new test despite the fact that it may have increased its overall commitment to residential mortgage finance.

Uncertainty over continued membership eligibility also harms the entire Federal Home Loan Bank System. As members fall out of eligibility, their stock in the FHLB must be redeemed, destabilizing the capital of the individual Banks, and because the System is a joint and several one, of the entire FHLB System. While this may seem relatively inconsequential on an individual bank basis, taken as a whole, with members falling in and out of membership and in and out of their stock contribution, the entire System will be viewed by the prudential regulators and the capital markets as less stable and reliable.

With less certainty over future availability of liquidity, banks may pull back from financing certain projects and investments, harming the communities they attempt to serve. A community that might benefit from a bank's growth or merger could suffer if that growth was stifled due to concerns over continued membership eligibility.

Based on data from the Council of Federal Home Loan Banks, 5,622 current FHLB members have been CFIs, but only 5,253 have consistently been CFIs. That means that 369 member banks have moved in and out of CFI status in that time. These banks, and likely more in the future, would face great uncertainty going forward due to the new 10 percent asset test.

With regard to captive insurance companies, an outright ban not only runs counter to the clear language of the authorizing statute (as discussed above) but would remove from the System members who are engaged in lending and other activities that provide a substantial benefit to their communities, as well as to the members of the Federal Home Loan Bank System. For example, one captive insurance company member provides servicing activities to the other members of their Federal Home Loan Bank. Having another member of the System provide reliable, quality servicing of loans is a benefit to the members of the System and the customers they serve. Imposition of the new rule would put those services at risk if not eliminate them entirely.

Our organization is enormously proud of the work our banks do to build stronger communities through providing access to credit for a broad range of our local customers' needs. Providing credit options to some of our banks and to the consumer is exactly what FHLBank enables our banks to do.

Under the current membership structure established by Congress, the Federal Home Loan Banks have proven to be a safe and sound business model that reliably supplies liquidity, through all market cycles, to a broad range of cooperative members for a variety of uses. The proposed rule would fundamentally change a vital part of the U.S. housing finance system that has and continues to perform well. It will restrict CFI's ability to serve their customers, result in the termination of FHLBank membership for some members in good standing, and ultimately reduce housing and economic development credit available to families, small businesses, and communities.

For these reasons, we request that the proposed rule be withdrawn and that the FHFA instead engage in a series of public hearings, workshops, and roundtables to solicit a variety of viewpoints from diverse stakeholders that may be impacted by this wide-ranging proposal. Thank you for the opportunity to submit a comment.

Sincerely,

Thad Woodard
President & CEO