



December 24, 2014

VIA [WWW.FHFA.GOV/OPEN-FOR-COMMENT-OR-INPUT](http://WWW.FHFA.GOV/OPEN-FOR-COMMENT-OR-INPUT)

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 Proposed Rulemaking; Request for Comments – Members of the Federal Home Loan Banks  
Comments/RIN 2590-AA39**

Dear Mr. Pollard:

The Federal Home Loan Bank of Atlanta (FHLBank Atlanta) appreciates the opportunity to comment on the Federal Housing Finance Agency's (FHFA) notice of proposed rulemaking and request for comments on "Members of the Federal Home Loan Banks" published on September 12, 2014 (NPR). The NPR reviews current statutory and regulatory provisions governing Federal Home Loan Bank (FHLBank) membership, proposes regulatory changes to the eligibility requirements for membership, and invites comments on all aspects of the NPR.

The FHLBank Atlanta district comprises seven states and the District of Columbia, spanning a large swath of the country and varying widely in culture, economic strengths, political philosophies, and community demographics. These differences are reflected in our membership composition – FHLBank Atlanta's 966 member shareholders are comprised of 673 commercial banks, 95 savings banks, 180 credit unions, 16 insurance companies, and 2 community development financial institutions (CDFIs). FHLBank Atlanta's broad membership provides financial services to rural towns as small as Pine Hill, Alabama (population 940) and metropolitan areas as large as the District of Columbia (of the nearly one thousand members, 688 are community financial institutions, with less than \$1.1 billion in assets (CFIs), and 2 are captive insurance companies).<sup>1</sup> These differences are also reflected in the variety of business plans and strategies that each member financial institution employs. Common to each of our member financial institutions, however, is their commitment every day to tailoring their financial products and services to the needs of their homeowner customers, small businesses, and communities, and often unique markets. The NPR proposals could significantly impact our member financial institutions, their communities, and the strength of the FHLBank Atlanta as a whole. We appreciate the opportunity to provide the following comments.

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<sup>1</sup> All membership numbers are as of September 30, 2014.

## I. Executive Summary

The NPR proposes several changes to the membership eligibility regulations, most significantly:

- Revising the current “makes long-term home mortgage loans” requirement to require all members to hold at least 1% of its total assets in “home mortgage loans,” both at the time of initial membership approval and on an ongoing basis (1% Test);
- Revising the current “10% residential mortgage loans” requirement applicable to non-CFI depository institutions to require compliance with this test on an ongoing basis (10% Test; together with the 1% Test, the Asset Tests);
- Requiring an FHLBank to calculate compliance with the Asset Tests annually, based on 3-year averages and to terminate membership of any member who fails either of the Asset Tests after a limited grace period; and
- Defining the term “insurance company” to exclude from FHLBank membership eligibility captive insurers, and requiring membership termination of all existing captive insurance company members after a 5-year wind-down period.

We respectfully request that the FHFA withdraw the NPR. Although the NPR raises well-intentioned concerns about members’ commitment to housing finance and preventing the abuse of FHLBank membership benefits, the solutions offered by the NPR are overly proscriptive and unnecessarily punitive. Specifically, we comment in this letter that the NPR should be withdrawn because:

- The current membership regulations already require a housing finance nexus, making the NPR unnecessary;
- The NPR will undermine the reliability of the FHLBanks as sources of liquidity;
- The NPR is contrary to the plain meaning of the Federal Home Loan Bank Act of 1932 (FHLBank Act) and Congressional intent;
- Membership termination is unnecessarily punitive;
- The NPR would be particularly harmful to small credit unions, CFIs and CDFIs;
- The NPR would negatively impact the FHLBanks’ Affordable Housing Programs; and
- Captive insurance companies have a housing nexus and any associated risks may be properly managed.

The FHFA would be better served by holding a series of public roundtable discussions with the many stakeholders, to explore fully the concerns the FHFA raises and possible alternatives to the NPR that may be more appropriate as alternatives to address those concerns without the potential disruption that may be caused by adoption of the NPR.

If the FHFA proceeds with final membership regulations, the FHFA should acknowledge the FHLBanks' authority over membership decisions and the great variety of members' business models by incorporating more flexibility into the final membership regulations. We believe the NPR could be improved by:

- Maintaining a presumptive compliance/rebuttable presumption approach to the asset tests;
- Clarify that the 1% Test may include mortgage loans that are sold into the secondary market during the year;
- Incorporating a minimum 3-year phase-in period for the Asset Tests for existing members;
- Providing an exception for small credit unions, CFIs and CDFIs;
- Providing an exception for certain events, such as severe market disruptions;
- Suspending access to certain membership benefits rather than terminating membership;
- Permitting institutions to appeal membership denials and terminations to the FHFA; and
- Clarifying what constitutes an "affiliate" and "primary business" for insurance companies.

## **II. NPR is Overly Proscriptive and Unnecessarily Punitive.**

In the preamble to the NPR, the FHFA cites several concerns with the existing membership eligibility regulations, all of which seem to suspect FHLBank members of lacking a commitment to housing finance.<sup>2</sup> The NPR attempts to address these concerns in an overly proscriptive and unnecessarily punitive fashion, with little regard for how the existing eligibility regulations enforce the housing nexus, and the wide diversity of business plans and operations that FHLBank members utilize to support their customers and communities.

### *A. Current Membership Regulations Require Housing Nexus.*

The proposed quantitative Asset Tests are unnecessary. The existing regulations already require members to maintain a nexus to the FHLBanks' housing finance mission, both at the time of admittance into the cooperative and on an ongoing basis.

The most evident example is the requirement that advances must be supported by mortgage-related collateral. An exception is made for community financial institutions (CFIs), which can pledge alternative forms of collateral including small business, agri-business, agricultural collateral, and community development loans as allowed by Congress. By definition, these forms of collateral are mission-consistent and therefore tie the uses of the advances to the holdings of the members obtaining them. The benefits of membership (access to low-cost funding and dividends on FHLBank stock) increase as member activity, and mortgage collateral pledged to the FHLBank, increase.

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<sup>2</sup> See NPR, Fed. Reg. Vol. 79, No. 77 (September 12, 2014) at 54849: "The absence of an ongoing requirement means that it is possible that an institution could reduce or eliminate its investment in long-term home mortgage loans [and residential mortgage loans] after becoming a member without affecting its eligibility to continue as a Bank member."

Another example is the requirement that the amount of long-term advances that can be made to a member are limited by the amount of total long-term residential housing assets currently held by that member. Further, members accessing long-term advances or Community Investment Cash Advances are selected randomly every two years by the FHFA to complete a Community Support Statement certifying that they actively support the first-time homebuyer market. The instructions to the Community Support Statement provide that the FHFA may restrict a member's access to long-term advances if the member's most recent federal Community Reinvestment Act rating is "needs to improve" or the member does not submit evidence of assistance to first-time homebuyers. Although infrequent, FHLBank Atlanta has received instructions from the FHFA in the past to restrict a member's access to long-term advances. In short, current regulations already maintain an on-going nexus between FHLBank members and housing finance.

The current regulations on membership eligibility at the time of application have worked well over the past 82-year history of the FHLBanks and the evolving home finance markets. The membership eligibility regulations require an applicant to demonstrate sufficient mortgage loan holdings at the time of admittance into membership, and permit the FHLBank (and thereby, indirectly, the existing membership) discretion to make qualitative assessments of potential members with different business plans. The NPR states the proposed quantitative and on-going requirements are necessary to avoid the possibility that an institution might reduce or eliminate its holdings after becoming a member. However, no data or empirical evidence is cited to support the FHFA's claim that "there have been instances" of this occurring.

In fact, the FHFA's own research shows that 97% of the banks and credit unions subject to the proposed 10% requirement would comply, while the vast majority of the remaining members would meet the proposed 1% test (99.2% of commercial and savings associations; 98.8% of credit unions; and 83.4% of insurance companies). This data was cited to show the minimal impact of the proposal, but we agree with FHLBank Chicago<sup>3</sup> that "it more clearly demonstrates the lack of a significant problem justifying such a sweeping and potentially disruptive proposal."

*B. The NPR Will Undermine the Reliability of the FHLBanks as Sources of Liquidity.*

The requirement that members must continually maintain a certain percent of their balance sheet in housing-related assets will undermine the reliability of the FHLBanks as a source of liquidity, particularly during times of economic distress.

The FHLBanks' core mission is to serve as a reliable source of liquidity for FHLBank member institutions in support of housing finance and community lending. The FHLBank System is designed, and operates most efficiently, by providing an easy-to-use liquidity mechanism for its members who hold eligible collateral – liquidity that the other financial markets may not always support, especially in times of distress. The long-term nature of FHLBank membership is a bedrock component of membership that enables the FHLBanks to be a reliable source of liquidity through strong and stressed market cycles.<sup>4</sup> The value of that liquidity to FHLBank members and to the broader housing finance market was convincingly demonstrated during 2007 and 2008 when the FHLBanks provided approximately \$370 billion of additional funding to FHLBank members, all of

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<sup>3</sup> FHLBank Chicago comment letter regarding the NPR, dated October 20, 2014, page 2.

<sup>4</sup> The average length of time as a member in FHLBank Atlanta is currently 17.5 years.

which was fully secured and fully capitalized. Our actions helped to stabilize the U.S. financial system when it needed it the most.

The NPR would undermine that reliability. By imposing ongoing requirements that restrict FHLBank membership, with no room for discretion on the part of the FHLBank or exceptions for extenuating circumstances, members could not be certain of their access to funding when the next crisis hits. During a crisis, collateral values can fall precipitously, changing the ratio of housing related assets to total assets, potentially placing a member out of compliance through no change of business plan or commitment to housing. While the NPR would measure ongoing compliance with the Asset Tests based on three-year averages, FHLBank Atlanta's internal calculations show that the number of members that would have failed the proposed tests during 2007-2012 increased as the recession worsened, and decreased as the recession subsided.

Members could fail to comply with the Asset Tests as a result of other activities. A member that merges with an institution that has few housing-related assets could result in a negative impact upon the surviving member's ratio of housing-related assets to total assets, even if the member has increased its commitment to funding residential mortgage assets in absolute dollar terms. A community bank that merges or grows organically above the CFI limit, which is adjusted annually, could fall out of compliance when its housing asset requirement jumps from 1 percent to 10 percent of total assets. Shifting between CFI status occurs frequently: of the 836 FHLBank Atlanta members who have been CFIs for at least one year since 2008, 659 have continuously been CFIs, while 177 were CFIs at some point during that time period. Applying the Asset Tests on an ongoing basis could materially impact how FHLBank members make strategic business decisions, could threaten their access to liquidity as a result of common business activities, and could penalize them at the very time that membership in the FHLBank may be most important to the member and the broader housing market.

The FHLBanks' analysis of the potential impact on FHLBank members suggests that the NPR could remove anywhere from \$107 billion to \$314 billion of liquidity from the financial market.<sup>5</sup> A dangerous precedent would be set if the FHFA begins establishing ongoing eligibility requirements for FHLBank membership. Even if members strive to meet the proposed tests, they could never be certain that the requirements might not be increased in the future by the FHFA, under the current or a future Director.<sup>6</sup> Their balance sheets always would be subject to the changing views of a regulator as to whether they were sufficiently devoted to housing finance, potentially politicizing membership and access to the FHLBanks.

*C. The NPR is Contrary to the Plain Meaning of the FHLBank Act and Congressional Intent.*

We have grave concerns, as do others,<sup>7</sup> that the NPR contravenes the intent of Congress and exceeds the FHFA's rulemaking authority. Since the adoption of the Act, Congress has continuously expanded the potential membership and mission of the FHLBank System beyond a narrow housing

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<sup>5</sup> See FHLBank Chicago comment letter, dated October 20, 2014, p. 4.

<sup>6</sup> The NPR states that although a 1% Test is being proposed, the FHFA will continue to consider whether the standard should be set at a higher percentage, such as 2% or possibly 5%. See NPR at 54859. The FHFA Office of Inspector General has urged FHFA to consider establishing a higher minimum threshold. See Federal Housing Finance Agency Office of Inspector General Semiannual Report to the Congress, April 1, 2014 through September 30, 2014, p. 43.

<sup>7</sup> See, e.g., Comment Letter of John E. Bowman, dated October 8, 2014, at pp. 1-2 and 22-26.

finance authority.<sup>8</sup> The FHFA's proposal to make membership eligibility requirements, including rigid quantitative tests, apply on an ongoing basis has no foundation in the Act or its legislative history.

Since passage of the FHLBank Act in 1932, Congress has reconsidered and amended the FHLBank structure and requirements many times. These changes demonstrate a clear preference for expanding the FHLBanks' mission beyond a narrow focus on housing finance. In recent decades, provisions affecting the FHLBanks were included in the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), the Gramm-Leach-Bliley Act of 1999 (GLBA), the Housing and Economic Recovery Act of 2008 (HERA), and most recently with the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank Act). Each time, Congress chose to broaden or expand the FHLBanks' reach, by expanding the types of financial institutions that are eligible to become members, by expanding the FHLBanks' mission through broader types of collateral that can be pledged to support advances, or by exempting the FHLBanks from provisions affecting other financial institutions. Each of these acts represent an opportunity for Congress to reconsider the scope of the FHLBank mission, yet notably Congress did not contract FHLBank membership or activity.

In fact, it appears clear that Congress intended the membership requirements to be analyzed at the time of membership approval, but for ongoing compliance Congress expected a member's access to advances, through eligible collateral limitations, to be the mechanism by which members accessing FHLBank advances would continue to support housing finance. The House Conference Report from FIRREA states that “[m]eeting the specific asset threshold test does not raise any presumption with respect to whether the applicant's policies are consistent with sound economic home financing. The member's access to advances, however, would be limited by that institution's demonstrated commitment to housing as provided under the advance section.”<sup>9</sup>

Currently several bills are under Congressional consideration to restructure and reform the government sponsored enterprises, including the FHLBanks. Every bill introduced to date has included provisions about the FHLBanks, typically about a role for the FHLBanks to perform in the future housing finance system. None of these bills has included any provisions that would restrict membership in any way, or impose an ongoing eligibility test, or exclude certain types of existing members from membership. Congressional expansion of the FHLBank mission has enabled the FHLBank System, and thereby its members, to remain responsive to the needs of homeowners and their communities as housing finance markets evolve.

#### D. *Member Termination is Unnecessarily Punitive.*

The NPR would terminate any member that fails to comply with the proposed Asset Tests. Because the FHFA is not the primary regulator of FHLBank members, terminating their membership in their FHLBank is the ultimate sanction the FHFA can impose upon FHLBank members.<sup>10</sup>

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<sup>8</sup> See HERA, 12 U.S.C. 4513; FIRREA, 12 USC 1424, GLBA, 12 USC 1430.

<sup>9</sup> H.R. Conf.Rep. 101-222, 423-24, *reprinted in* 1989 U.S.C.C.A.N. 432, 463-64.

<sup>10</sup> The mandate that a Bank automatically terminate membership based on the Asset Tests also contradicts the express shift of authority to the board of directors of each FHLBank to deny or terminate membership. Prior to the GLBA, the FHFB had the authority pursuant to Section 6(e) of the FHLBank Act to terminate membership in an FHLBank.

Membership in an FHLBank is not intended or designed to be a fleeting lender-borrower relationship. This is clear from the capital stock provisions of the FHLBank Act and existing regulations, which provide for automatic transfer of membership when a member institution moves its principal place of business or consolidates with another member, the fact that advances may remain outstanding until maturity when a member merges into a nonmember institution, the nontransferability of FHLBank capital stock, the five-year redemption period, and the five-year bar against readmission to membership. Yet the NPR is surprisingly blasé about the effect of automatic termination of membership on a long time member, as if the small percentage of members that the FHFA estimates might fail the Asset Tests is sufficient consolation to an individual affected institution. The NPR does not explore any factual circumstances about the institutions that it estimates might lose their membership, such as whether those members are selling their housing mortgage assets into the secondary market or have skewed year-end numbers due to seasonal lending changes.<sup>11</sup>

Additionally, the NPR does not address whether members terminated due to noncompliance with one of the Asset Tests would be subject to the five-year prohibition on readmission or whether they could be re-qualified for membership as soon as they were able to show that they were back in compliance with the requirement. The NPR does not discuss the effect of mandatory termination under the stock redemption periods and leaves unanswered the question of whether a terminated member that continues to hold stock in the FHLBank but comes into compliance prior to its stock being redeemed would be able to remain a member upon showing compliance with the requirement. The NPR also does not specify the mechanisms by which the FHLBanks could obtain the asset information required – much of which may be restricted from disclosure by the members’ regulators; this could possibly create a conflict for the member with its prudential regulator. The FHFA itself notes difficulty in compiling a complete picture of members’ finances.<sup>12</sup>

Further, by terminating members that failed to comply with the proposed Asset Tests, the capital stock base of an FHLBank would become more volatile and less stable as stock is redeemed or repurchased. This could impact the capital adequacy of an FHLBank and its effectiveness in meeting housing finance and community development policy objectives.

The uncertainty and volatility that the Asset Tests create, and the extreme penalty of automatic termination, will make membership less beneficial to all institutions.

*E. The NPR Would Be Particularly Harmful to Small Credit Unions, CFIs and CDFIs.*

The impact of the NPR will be disproportionately felt by FHLBank smaller members – particularly small credit unions (under \$1.1 billion in assets), CFIs and CDFIs – the vast majority of which lack access to other sources of reliable, economical funding on a same-day basis.

The NPR would require every CFI member to hold on its balance sheet a specified amount of home mortgage assets as a condition for continued membership, in spite of the fact that Congress has

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<sup>11</sup> This was raised as a possible issue by comments on the advanced notice of proposed rulemaking issued in December 2010; *see* NPR at 54850.

<sup>12</sup> *See* NPR at 54859-60. The FHFA also notes that regulatory financial reports are subject to change, and that the FHFA would likely need to issue guidance periodically to address any questions about how the FHLBanks are to extract the relevant data from those reports.

authorized and encouraged the FHLBanks to make advances to CFIs to support funding for expanded activities in other asset categories involving small businesses, small farms, small agribusinesses, and community development activities.

The NPR would similarly require credit unions to comply with the broader 1% Test and the 10% Test on an ongoing basis, without any exception for small credit unions, who will have less flexibility than their larger counterparts to adjust their balance sheet levels.

Through HERA, Congress has also expanded FHLBank membership eligibility to include CDFIs.<sup>13</sup> In 2010, the FHFA issued a final rule implementing this provision of HERA to help facilitate CDFI membership in the FHLBanks.<sup>14</sup> The 1% Test could be especially difficult for some CDFIs. The specific assets that CDFIs hold in portfolio may not meet the strict definition of the 1% Test since many CDFIs may hold only part of a “participation loan” and may hold business loans and loans to developers of affordable housing units that would not count toward the 1% Test. Imposing new onerous membership requirements on CDFIs would be in conflict with Congress’ stated intent to make CDFIs eligible for FHLBank membership.

Based on internal calculations, five FHLBank Atlanta CFI members and seven credit unions would have failed the ongoing 1% Test at least once during 2008-2013, and at least nine CFIs and one credit union would have been close to failing. When these community institutions are harmed, the impact is felt by the smaller, more rural communities typically served by such FHLBank members.

*F. The NPR Would Negatively Impact the FHLBanks’ Affordable Housing Programs.*

Building affordable housing through the FHLBanks’ affordable housing programs (AHP) typically is the result of a working partnership between a developer, a member institution, and an FHLBank. Affordable housing developers often establish long-standing relationships with specific member institutions, and those consistent relationships allow the developers to more efficiently obtain funding, meet compliance requirements, and complete successful projects that spur economic development. The NPR introduces the threat that these relationships will be disrupted at any point in the lifecycle of an affordable housing project due to the termination of the member institution’s FHLBank membership based on the new standards set forth in the NPR. The permanence currently associated with membership in an FHLBank<sup>15</sup> would be lost. Affordable housing developers will have to worry that the member institutions with whom they partner will be involuntarily forced out of the AHP program prior to project completion due to unrelated fluctuations in the member’s asset composition. We believe this would have only a negative effect on the fulfillment of FHLBank affordable housing mission. The potential loss of FHLBank members and resulting decline of advances would likely reduce net income, in turn reducing available AHP funds.

*G. Captive Insurance Companies Have Housing Nexus and May Be Properly Overseen.*

In its haste to prevent abuse of FHLBank membership by institutions who are not directly eligible for the benefits of membership, the NPR categorically eliminates captive insurance companies from FHLBank membership through a narrow definition of insurance company. This approach dismisses

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<sup>13</sup> HERA 1206, 12 U.S.C. 1424(a)(1), amending the Section 4(a)(1) of the FHLBank Act.

<sup>14</sup> 76 Fed. Reg. 678 (Jan. 5, 2010).

<sup>15</sup> The average length of membership in FHLBank Atlanta is currently 17.5 years.



the inconsistent treatment of the affiliate/parent relationships of captive insurance companies and affiliate/parent relationships of depository institutions. It also overlooks the variety of captive insurance companies that exist, including captives that are strongly committed to and support the residential mortgage market, and the difficulty of creating clear delineations between insurance companies. Congress has specifically addressed FHLBank membership three times within the last twenty years, the period in which captive insurance companies became FHLBank members, and in reviewing FHLBank membership Congress expanded it in each instance. We agree with other commenters that captive insurance companies are insurance companies,<sup>16</sup> that by its absence of action Congress has intentionally kept insurance company membership flexible and expansive, and that the FHFA is potentially overstepping its authority and contradicting public policy by categorically excluding captive insurance companies.<sup>17</sup>

The FHLBank Act eligibility requirements ensure that FHLBank members, including insurance companies, support the FHLBank mission and the safety and soundness of the mortgage market. The FHLBank Act does not include restrictions on an FHLBank member's use of proceeds, does not provide limitations on the ownership structure of statutory eligible members and does not require that eligible members be "principally engaged" in a particular business. The FHLBanks have been extremely adept at managing its membership and loan program to support its housing mission, having never suffered a credit loss.

Captive insurance companies are often actively involved in the housing finance market. Captive insurance companies affiliated with mortgage real estate investment trusts (REITs), for example, fulfill the mission of the FHLBanks to support communities across the United States by providing much needed long-term private capital to the residential mortgage market. Mortgage REIT holdings of the residential mortgage market have increased and continue to increase as other forms of residential mortgage funding have shown weakness during the recent financial crisis. Mortgage REITs and their related captive insurance companies have furthered housing affordability for consumers by originating mortgage loans, purchasing mortgage-backed securities, providing first loss capital for new private label securitizations, and owning and financing rental housing. Association captive insurance companies may underwrite insurance for members who are actively involved in the housing market. The proposed definition of insurance company could unnecessarily exclude these types of insurance companies. The NPR also creates uncertainty because it does not address how the FHLBanks should determine an insurance company's "primary business" or what constitutes "nonaffiliated persons or entities."

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<sup>16</sup> See, e.g., the Venable comment letter dated October 8, 2014 pp. 16-19. The NPR argues that although insurance companies have been eligible for membership since the inception of the FHLBank System in 1932, captive insurance companies were not contemplated because "[t]he first captive insurer in the U.S. is generally thought to have been a subsidiary of the Youngstown Sheet and Tube Company that was chartered in Ohio in the 1950s." See NPR at 54853, fn. 32. However, captive insurance companies were in existence as early as the late 1800s, when a group of 26 New England textile manufacturers formed a captive insurance company that later became FM Global. *The Regulation of South Carolina Captive Insurance Companies*, Tom Brumgardt, Nelson Mullins Riley & Scarborough LLP, March 5, 2014 presentation to Federal Home Loan Bank of Atlanta.

<sup>17</sup> See Dechert LLP comment letter, dated October 31, 2014, pps. 16 – 22, and letter dated October 6, 2014 from Milton J. Miller, II, former President-CEO of FHLBank Indianapolis.

### **III. Public Roundtable Discussions Would Be A More Appropriate Next Step.**

As discussed above, FHLBank Atlanta believes the NPR raises significant potential problems for its member institutions that could fundamentally alter the relationship between members and the FHLBanks. We are hardly alone in this concern; nearly all of the 137 comment letters in response to the advance notice of proposed rulemaking issued in December 2010 were opposed to revising the membership regulation, and to date, over 300 comment letters have been filed in response to the NPR, from current FHLBank members, financial regulators, trade associations, community development institutions, housing advocates, and members of Congress. The number and tenor of these comments should give the FHFA serious pause about the legal and public policy arguments the NPR asserts. We believe that the most prudent course of action would be to suspend further rulemaking on this proposal until after the FHFA has had the opportunity to hold a series of public meetings, workshops, or roundtable discussions across the country with the numerous stakeholders who will be directly impacted by any final membership eligibility changes. We are not the only commenter seeking further dialogue on this NPR; for example, the South Carolina Department of Insurance invites the FHFA to have more discussion with state insurance regulators about the level of oversight they provide.<sup>18</sup>

Public roundtable discussions are routinely held by other federal regulatory agencies prior to finalizing regulations with significant policy implications.<sup>19</sup> Such discussions would provide FHFA input from the numerous stakeholders in a forum more conducive to mutual education and to brainstorming creative alternatives. We offer some possible alternatives to the NPR below, but these ideas and others should be publicly discussed and thoroughly analyzed with all affected parties.

### **IV. Any Final Membership Eligibility Regulations Should Incorporate More Flexibility.**

We agree with the FHFA's fundamental goal of ensuring that the benefits of membership, including access to low cost funding and the receipt of dividends on FHLBank stock, are reserved for institutions that are likely to use those benefits to fulfill the primary purposes of the FHLBank Act. Any member that abuses access to those benefits or attempts to undercut the FHLBank mission puts all other FHLBank members at risk. However, the NPR's rigid, one-size-fits-all approach raises numerous issues, as discussed above. Any final regulations should retain the discretion that Congress has provided the FHLBanks. The solutions should punish the wrongdoer, not the entire membership.

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<sup>18</sup> Letter dated October 31, 2014, from Raymond G. Farmer, Director of the Department of Insurance in the state of South Carolina.

<sup>19</sup> In 2013 the Securities and Exchange Commission held public roundtable panels in response to the staff's December 2012 Report on Assigned Credit Ratings. Prior to the Federal Deposit Insurance Reform Act of 2005, the Federal Deposit Insurance Corporation (FDIC) held a roundtable on deposit insurance reform (2000), released a paper discussing the policy concerns and options (August 2000), conducted intensive analysis and outreach to hundreds of individual bankers, developed recommendations for deposit insurance reform (April 2001), and collaborated with Congress (e.g., appearances by Donald E. Powell, Chairman, FDIC on deposit insurance reform before the Committee on Banking, Housing and Urban Affairs, U.S. Senate, February 26, 2003, before the Committee on Financial Services, U.S. House of Representatives, March 4, 2003).

A. *The NPR Should Maintain a Presumptive Compliance/Rebuttable Presumption Approach.*

The presumptive compliance and rebuttable presumption approaches of the current membership eligibility regulations have served the FHLBanks well for over a decade. The FHLBanks have the authority to approve membership and should continue to have the statutorily prescribed authority to use their discretion in resolving membership issues that arise in their unique mix of members.

Under the current “makes long-term mortgage loans” requirement for applicants (Section 1263.6(a)(3)), an applicant is deemed to be in compliance if it “originates or purchases long-term home mortgage loans” (Section 1263.9), suggesting that an FHLBank may determine other evidence of compliance with the requirement, and an FHLBank may rebut this regulatory presumption of compliance (Section 1263.17(a)). The current 10% test for non-CFI insured depository institution applicants follows this same presumptive compliance approach (Sections 1263.6(b), 1263.10, and 1263.17(a)). Even an eligibility requirement as seemingly concrete as the requirement to be “duly organized” (Section 1263.6(a)(1)) follows this same structure. This structure appropriately permits the Bank flexibility to assess individual cases. We suggest that any quantitative requirement for the Asset Tests serve as a presumptive compliance threshold, rather than a bright line test.

The delegation of membership approval authority allowed each FHLBank to implement policies governing approval of applicants for membership that are appropriate for its business, such as whether advances may be safely made to an applicant, and its district. For example, FHLBank Atlanta has adopted a member eligibility policy that provides requirements that new member applicants, including insurance companies and non-credit union CDFIs, must meet to be deemed compliant with the current eligibility regulations. Our policy provides guidance through the use of quantitative thresholds, but also permits exceptions to be granted by the FHLBank Atlanta’s executive management committee after an appropriate level of internal review. FHLBank Atlanta’s board of directors has delegated approval, but not denial, of membership applications to certain senior officers. This flexibility allows FHLBank Atlanta (and indirectly, the entire FHLBank Atlanta membership) to make qualitative assessments of an applicant’s commitment to the FHLBanks’ housing finance mission when appropriate.

*“Flow” Business*

Members that from time to time sell some or all of their mortgage holdings into the secondary market necessitate a more qualitative assessment. For example, one FHLBank Atlanta member routinely originates mortgage loans that it then sells into the secondary market. In one year, this member originated mortgages loans in an amount that actually exceeded the institution’s year end asset number. This example fits within the current regulatory requirement that an applicant “originates or purchases” mortgage loans, and clearly indicates that the member is significantly involved in the home mortgage loan market, yet under the NPR, this member could fail both the ongoing 1% makes test and the 10% test unless it adjusts its business model to retain mortgage loan assets on its books at year end. Even if such a change in business model is feasible for this member, the justification for imposing the NPR is inapplicable in this example.

We suggest that the proposed annual calculation for the Asset Tests, at a minimum, be revised to allow for reporting by the member the amount and percentage of all residential mortgage loans and long-term home mortgage loans made or purchased by the member during each of the three relevant years, including loans originated that will be or were subsequently sold within the secondary

market and those originated through subsidiaries. This information could be provided in the form of a worksheet that the member certifies, similar in format to the current Community Support Statement and likely similar to how each FHLBank currently determines the one-time compliance with the tests for each applicant. However, obtaining a certification from the member's external auditor regarding the reported information would likely result in additional costs to the member with little additional benefit to the integrity of the FHLBank mission.

*B. Phase-in Period for Asset Tests for Current Members*

The NPR will require existing members to comply with the Asset Tests, based on three-year averages, with all numbers being determined as of the end of each of the preceding three calendar years. The FHLBanks will be required to perform the compliance calculation annually, as soon as practicable after the preceding year-end numbers become available. The NPR does not include any phase-in period for these tests, meaning existing members would be subject to the ongoing tests immediately upon publication of the final rule, based on the prior three years' activity when these tests did not exist.

Since the rule may force members to make adjustments to their business strategies and balance sheets in order to ensure compliance with these ratio tests, any final rule should allow members time to make these adjustments with as little impact to their financial condition as possible. For example, if a final rule imposing these ongoing tests is published in 2015, the final rule should provide that the FHLBanks are required to perform the first annual calculation of compliance with these tests no earlier than 2019, so that members have had full knowledge of the final requirements during all three years included in the calculations (in this example, during 2016-2018) and had time to adjust their business activities for those years if necessary. We strongly urge the FHFA to consider a longer phase-in period if the final rule is expected to be published during the second half of a year, when most institutions' strategic plans and business initiatives are already in planning or underway for the upcoming calendar year. Finally, any cure period should be a minimum of three years. Depending on which year's numbers caused the member to fail the three-year average calculation, the member may potentially need three years to get the three-year average back into compliance. This cure period should be even longer during a recession, particularly one that is driven by a housing market downturn.

*C. Exceptions for Certain Categories of Members and Events.*

If the final rule adopts the NPR's quantitative Asset Tests, without the presumptive compliance or FHLBank discretion approach that we recommend above, the final rule should provide explicit exceptions for (a) CFIs, CDFIs, and small credit unions (\$1.1 billion or less in total assets), and (b) mergers and severe market disruptions. As we noted above, the NPR is particularly harmful to small credit unions, CFIs and CDFIs due to the nature of their activities and contrary to clear Congressional intent to allow special treatment of these entities. Circumstances could result in a member failing one of the quantitative Asset Tests through no actual change in a member's commitment to housing finance. Perhaps such exceptions could be in the form of automatically changing the calculations from a three-year average to a four-year average if a merger has occurred, or a temporary cessation of the tests for members during any national recession. We do not presume to know whether these examples would be feasible for all FHLBank members across the country, and urge that these and other possible ideas be fully discussed and explored before a rule is finalized.

D. *The FHFA Should Consider Alternatives to Termination of Membership.*

Rather than impose automatic termination of membership, the FHFA should consider other less draconian alternatives that may support the goal of limiting the benefits of membership to institutions that are supporting the FHLBank mission.

Possible alternatives, which should be explored fully in public roundtable discussions, could include:

- Suspending a member's access to long-term advances until the member is back in compliance; or
- Requiring a member to submit a formal compliance plan to the FHLBank to indicate how the member intends to return to compliance.

E. *Appeals of Membership Denials and Terminations.*

The FHFA specifically requests comment on whether it should continue to permit applicants that have been denied membership to appeal such denials to FHFA (Section 1263.5). If a final rule incorporates the NPR's quantitative Asset Tests without any revision for FHLBank discretion, an applicant should be permitted to appeal a denial of its membership application to the FHFA. Further, if the NPR's automatic membership termination provisions are incorporated into a final rule, Section 1263.5 should permit a member who has received notice of membership termination under proposed Section 1263.28(c) to appeal the termination of its membership; the FHFA cannot logically reclaim authority for this particular instance of termination without also restoring the procedural rights and obligations that counterbalance such authority.<sup>20</sup> Given the significant repercussions, and the length of time before an institution could apply to be re-admitted to FHLBank membership, an institution should have the opportunity to plead its case to the FHFA if extenuating circumstances have made application of the tests inappropriate, or if the institution disputes the application of proposed Section 1263.28(b).

F. *The Effects of Automatic Membership Termination Should Be Clarified.*

As discussed above, the NPR does not address details after a member is terminated under Section 1263.28 such as the effect under stock redemption periods, and the five-year prohibition on readmission. These details should be clarified in any final rule that retains the automatic termination proposal. Further, the FHFA should clarify whether it expects the FHLBanks to amend their capital plans to reflect the automatic termination provision, whether outstanding advances to members terminated due to loss of eligibility may remain outstanding until maturity, and whether dividends may continue to accrue and be paid in the ordinary course for institutions whose membership has been terminated under Section 1263.28.

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<sup>20</sup> Prior to the enactment of the GLBA, Section 6(e) of the FHLB Act provided in part: The [FHFB] may, after hearing, remove any member from membership, if in the opinion of the [FHFB], such member (i) has failed to comply with any provision of this chapter or regulation of the [FHFB] made pursuant thereto; (ii) is insolvent ... or (iii) has a management or home-financing policy of a character inconsistent with sound and economical home financing or with the purposes of this chapter.

*G. Definition of Insurance Company Should Be Clarified.*

We echo the comments of other letters in objecting to the NPR's questionable definition of insurance company. As discussed above, the NPR is so focused on eliminating pure captives that it fails to recognize that some captive insurance companies, and association captive insurance companies, may be underwriting activities in the home building and finance industry that directly support the FHLBank mission. Any risks unique to accepting captive insurance companies can be managed by the FHLBanks through prudent safety and soundness and risk management practices, rather than through an outright elimination of captive insurance companies from membership eligibility.

For example, a mutual insurance company may be incorporated as a mutual insurer under the state of Georgia captive insurance company statute as an "association captive insurance company"<sup>21</sup> Such an insurance company may be called a captive insurance company (indeed, may even have "captive" in its name), but is fundamentally different from the type of captive that exists solely to support the financial needs of a parent corporation. As a mutual, it is owned by its policyholders and has no corporate parent, and it may only sell policies to members of sponsoring "associations" (e.g., property and casualty insurance for homebuilders and related trades). Under the NPR's definition of insurance company, it is not at all clear whether the FHFA would deem this an impermissible captive insurance.

To recognize these types of captive insurance companies whose underwriting activity is clearly correlated to the FHLBank mission, we suggest FHFA refine the proposed definition of "insurance company" in Section 1263.1 to clarify how it defines (a) "primary business" and (b) "nonaffiliated persons or entities."

We suggest FHFA add the following definitions to Section 1263.1:

"Nonaffiliated persons or entities" means one or more persons or entities holding less than 50% equity ownership or voting control of the insurance company.

An insurance company's "Primary business," means a business line (such as selling policies, including reinsurance policies or contracts of reinsurance) that constitutes more than half of the insurance company's business.

All other eligibility requirements for insurance companies to attain and maintain FHLBank membership, such as the subject to inspection and regulation requirement, should continue to apply to captive insurance companies.

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<sup>21</sup> O.C.G.A. §33-41.2(1). Georgia's captive insurance companies statute acknowledges associations and association captive insurance companies as follows:

"Association" means any membership organization whose members consist of a group of individuals, corporations, partnerships, or other associations who engage in similar or related professional, trade, or business activities and who collectively own, control, or hold with power to vote all of the outstanding voting interests of an association captive insurance company.

"Association captive insurance company" means any domestic insurance company granted a certificate of authority under this chapter to insure or reinsure the similar or related risks of members and affiliates of members of its association.

**V. Conclusion**

For the reasons stated above, FHLBank Atlanta requests withdrawal of the NPR, at least until such time as the FHFA has had the opportunity to hold a series of public roundtable discussions with stakeholders to discuss the significant policy and practical concerns that the NPR raises and to explore less severe alternatives, such as suggested by FHLBank Atlanta above, which we believe would improve the NPR.

We greatly appreciate your consideration of these comments.

Sincerely,

A handwritten signature in cursive script that reads "W. Wes McMullan".

W. Wes McMullan  
President and Chief Executive Officer  
FHLBank Atlanta