



January 7, 2015

Mr. Alfred M. Pollard  
General Counsel  
Federal Housing Finance Agency  
400 7th Street, SW, Eighth Floor  
Washington, D.C. 20024

**Re: FHFA Proposed Rule – Members of Federal Home Loan Banks, RIN 2590-AA39**

Dear Mr. Pollard:

The Community Bankers Association of Illinois (“CBAI”), which proudly represents approximately 380 Illinois community banks and thrifts, of which approximately 290 are Federal Home Loan Bank (“FHLB” or “FHLBank(s)”) members (“Members”), appreciates the opportunity to provide our observations and recommendations on the Federal Housing Finance Agency (“FHFA” or “Agency”) proposed revisions to FHLB membership eligibility requirements (“Proposed Rule” or “Proposal” or “Rule”) particularly regarding the “one percent” and “10 percent” on-going versus one-time basis requirements for membership. Given the length, complexity, and the intended and unintended consequences of the 137 page Rule, CBAI requested and appreciated being granted an extension of the comment period to allow for a thorough analysis and an in-depth discussion of the Proposed Rule with our members and executive staff.

It is clear that if the Proposed Rule is adopted it would have a profound impact on the FHLB system (“System”), FHLBanks and Members including but not limited to: increased regulatory burden and difficulties in Member balance sheet management; the stability of the System and its continued reliability as a funding partner particularly in times of economic stress; uncertainty

about continuing Member access to liquidity; the future value of FHLBank membership and the implications for membership decisions; and the impact on housing and community development throughout the System. Please find detailed below our comments on these and other areas of significant concern to CBAI and its community bank and thrift FHLB Members.

It is worth noting that CBAI raised many of these concerns regarding the FHFA's 2010 Advanced Notice of Proposed Rulemaking ("ANPR") on this subject. The Agency wisely did not move forward at that time but is now requesting comments on the Proposal. CBAI wonders what the FHFA did not understand about the overwhelmingly negative comments in response to the ANPR; and why the FHFA did not appreciate the concerns expressed about it by both Congressmen Barney Frank (D-MA the then-Chairman of the House Financial Services Committee) and Spencer Bachus (R-AL the then-Ranking Member of the Committee.)

CBAI respectfully recommends the FHFA not again "shelve" but formally withdraw the Proposed Rule.

### **Increased Regulatory Burden on Community Banks and Thrifts**

It is an indisputable fact that regulatory burden falls disproportionately hard on Main Street versus Wall Street. Main Street community banks and thrifts must comply with the same laws, rules and regulations as larger banks and financial firms but must spread the costs of compliance over a smaller number of customer relationships and employees. Thankfully, the most senior banking regulators are increasingly recognizing this fact as a critical problem and implementing tiered regulation to provide community banks and thrifts with a modicum but growing degree of regulatory relief.

If this Rule is implemented the ongoing regulatory compliance burden of monitoring and complying with membership eligibility requirements will be an additional regulatory burden, and one which falls disproportionately hard on community banks and thrifts. In addition, they would face uncertain access to a reliable source of liquidity with fewer available alternate sources of liquidity, and greater difficulties in liquidity management and contingency planning.

Particularly during the financial crisis and the resulting Great Recession, community banks and thrifts also faced significantly more harsh regulatory scrutiny, examination and enforcement than

Wall Street banks and financial firms. They have every reason to believe that examiners will closely inspect and criticize these smaller Members for making difficult and perhaps no-win decisions regarding FHLB membership if the Proposed Rule is implemented.

### **Members' Balance Sheet Management Practices and Decreasing Flexibility to Respond to Changing Conditions**

Community banks and thrifts are spending increasingly limited time and resources on budgeting, variance analysis, sensitivity analysis, rate shock scenarios, asset-liability management, and capital, liquidity and contingency planning. This has occurred as a result of the number and velocity of events impacting banks, the financial system and economy, regulatory requirements, and generally sound banking practices. The Proposed Rule imposes the requirement that a portion of Members' assets be held in certain approved loans or investments in order to maintain membership. At a time when speed and flexibility in reacting to various threats and opportunities is not only desired but required, the Proposed Rule freezes a portion of a Member's balance sheet with the specter that if the asset mix changes, membership in their FHLBank could be jeopardized. It is conceivable that a change in a Member's asset mix, while necessary and desirable for a variety of sound business and/or regulatory reasons, would trigger a violation of FHLB membership requirements and could result in expulsion from their FHLBank. This potential conflict places community banks and thrifts in an unfortunate, unnecessary and untenable position. The fact that some consider the proposed percentage of assets to be modest completely misses the point that any on-going level of assets required to be held in certain approved loans or investments is unprecedented and wrong.

### **Stability of the System, Ongoing Requirements for FHLB Membership and Threatened Expulsion for Non-compliance**

A stable FHLB System consists of Members which are assured of their ability to maintain their membership to enable them to take advantage of the System's various programs and services, which, over time, have been developed with Member value in mind. An essential hallmark of the System is that when an applicant qualifies and joins the System it is certain of being able to take advantage of the programs and services both in good and bad times, so long as it has the available collateral to support those activities. The Proposed Rule imposes a continuing

requirement for membership and threatens expulsion for non-compliance, both of which put the certainty of membership at risk and threatens the stability of the System. Never in the 82 year history of the FHLB System have there been such on-going requirements and penalty of expulsion for non-compliance.

### **Undermining the Certainty of FHLBs as a Reliable Liquidity Provider, Particularly for Community Banks and Thrifts Which Lack Alternatives**

Requiring Members to meet on-going requirements adds an element of uncertainty to FHLBank membership and the possibility of terminating membership is a harsh punishment for non-compliance. Members could never be sure of their ability to meet these on-going requirements and therefore maintain membership in FHLBanks for liquidity purposes. This situation will be particularly problematic in times of financial stress. During the recent financial crisis, the FHLBanks provided funding nationwide to their Members for liquidity, housing and community credit needs. As other sources of liquidity rapidly disappeared during the financial crisis, over a period of 18 months in 2007-2008, the FHLBanks increased their lending to Members by 50% from approximately \$600 billion to over \$1 trillion. Equally impressive is that during the subsequent 15 months, as other sources of liquidity slowly reappeared, the FHLBanks successfully reacted and advances decreased to approximately \$600 Billion. The FHLB system was one of the only financial services providers that were able to respond to the financial crisis in a rapid and positive way.

The Proposed Rule is particularly harmful to community banks and thrifts because they do not have the broad range of liquidity options available to them as those enjoyed by Wall Street banks. Imposing continuing requirements for membership and threatening expulsion for non-compliance would have had serious adverse consequences for these Members and the broader financial system had they been in effect during this financial crisis, and will negatively impact the FHLB System's ability to assist them, the financial system and the economy during future crises.

### **Undermining Financial Regulators' Focus on Liquidity Planning to Withstand Another Financial Crisis**

The recent financial crisis heightened regulators' concerns about liquidity and contingency

planning. By injecting uncertainty into ongoing membership in the FHLBanks the Proposed Rule undermines access to this reliable source of liquidity particularly for community banks and thrifts during periods of financial stress. It is disturbing why the FHFA would propose such a restriction given the obvious benefits of the existing membership requirements. CBAI will be surprised and disappointed if the banking regulators do not weigh-in against the Proposed Rule for significantly and negatively impacting the liquidity of the community banks and thrifts they regulate to maintain their safety and soundness. We encourage the regulators to do so and will deliver copies of CBAI's comment letter to the Federal Reserve Bank, FDIC, OCC, and the Illinois Department of Financial and Professional Regulation.

### **Future Value of FHLBank Membership and the Impact on Membership Decisions**

If the Proposed Rule is implemented the FHFA will have firmly established that it can subsequently and unilaterally change membership rules which community bank and thrifts relied on when they made their membership decisions and which these Members reasonably believed were sacrosanct. This *after the fact* changing of the rules could not be ignored by prospective Members. Their logical question will be "What will happen next?" The result will be a serious devaluation of FHLB membership, a disincentive to become a Member, a smaller and less efficiently operating FHLB System, fewer profits, and a less effective contribution by the System to support the liquidity and funding for housing finance and community investment. These will be the unfortunate consequence of implementing the Proposed Rule.

### **Usurping the Traditional Role of Congress in Determining FHLB Membership Eligibility**

Any changes to FHLBank membership, especially those that would restrict membership, should come from Congress. When Congress has examined FHLBank membership in the past, the results have been to expand rather than contract the role of the FHLBanks. The FHFA should not attempt to fundamentally alter the FHLBank System and membership requirements, particularly for community banks and thrifts, without express Congressional guidance. This is particularly true at this time when Congress is in the midst of undertaking a review of the housing finance system, including a review of the important role served by FHLBanks as a provider of Member products and services.

It is disturbing why the FHFA is proposing restrictions on membership which have traditionally been outside of its purview. In fact 70 United States Representatives and 30 United States Senators have signed bi-partisan Member Letters opposing the Proposed Rule, as the FHFA is interfering in their role in determining membership eligibility. We expect and encourage more Members of Congress to comment on the Rule, and we will deliver copies of CBAI's comment letter to all 20 members of the Illinois Congressional Delegation.

### **Impact on Community Development and Housing Programs**

At a time when policymakers should be looking for ways to jump-start housing, economic activity and community development by encouraging increased lending, the changes being considered in the Proposed Rule threaten to limit access to the low-cost funding provided by the FHLBanks which support these activities. This is a clear example of mixed messages being sent from Washington D.C. which continue to create uncertainty and impede the housing and economic recovery. CBAI wonders how the consequences of implementing this Rule could possibly be consistent with the mission of the FHFA - which is to ensure the housing GSEs (including the FHLBanks) "serve as a reliable source of liquidity and funding for housing finance and community investment."

It is necessary to highlight that the impact of the Proposed Rule will fall disproportionately hard on community banks and thrifts serving "rural and underserved" areas. These areas have been largely abandoned by Wall Street and are almost exclusively being served by community banks and thrifts. The Consumer Financial Protection Bureau ("CFPB") recently recognized the importance of "small creditors" and granted an exception to the Ability-to-Repay and Qualified Mortgage (QM) Standards for "small creditors" operating in "rural and underserved" areas. Any increased regulatory burden, or decreased access to the valuable products and services offered by FHLBanks to its Members, will cause community banks and thrifts to be further challenged in serving "rural and underserved" areas. This is a clear example of – where one federal agency (CFPB) giveth – another federal agency (FHFA) taketh away, and is an unfortunate example of federal agencies that are not communicating or coordinating with one another in the rulemaking process.

## **Conclusion and Recommended Action**

The restrictive membership requirements and threat of expulsion being proposed in the FHFA's Rule would make unprecedented, unnecessary and harmful changes to membership in FHLBanks, particularly for community banks and thrifts. Determining membership criteria has historically been within the purview of Congress and Congress has consistently expanded (not contracted) membership eligibility requirements. The Proposed Rule would make it problematic for Members to access liquidity through FHLBank advances at a time when banking regulators are requiring them to establish and maintain various reliable sources of liquidity. The Proposed Rule will devalue membership for existing FHLBank members and discourage potential members from joining. These changes will be especially burdensome for community banks and thrifts, at a time when they are already subject to a crushing regulatory burden. Finally, they will inhibit the ability of FHLBanks to serve the housing and community development needs of their districts, particularly in "rural and underserved" areas.

CBAI respectfully recommends the FHFA completely withdraw the Rule. This harmful proposal does not need to be further delayed or studied but needs to be completely abandoned.

Thank you for considering our observations and recommendations. If you have any questions or need additional information please do not hesitate to contact me at (847) 909-8341 or [davids@cbai.com](mailto:davids@cbai.com).

Sincerely,

/s/

David G. Schroeder  
Vice President Federal Governmental Relations

cc: Federal Reserve Bank of Chicago  
Federal Deposit Insurance Corporation – Chicago Regional Office  
Office of the Comptroller of the Currency – Central District  
Illinois Department of Financial and Professional Regulation

Federal Housing Finance Agency

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The Honorable Richard Durbin, Member of Congress

The Honorable Mark Kirk, Member of Congress

The Honorable Mike Bost, Member of Congress

The Honorable Cheri Bustos, Member of Congress

The Honorable Danny Davis, Member of Congress

The Honorable Rodney Davis, Member of Congress

The Honorable Robert Dold, Member of Congress

The Honorable Tammy Duckworth, Member of Congress

The Honorable Bill Foster, Member of Congress

The Honorable Luis Gutierrez, Member of Congress

The Honorable Randy Hultgren, Member of Congress

The Honorable Robin Kelly, Member of Congress

The Honorable Adam Kinzinger, Member of Congress

The Honorable Dan Lipinski, Member of Congress

The Honorable Mike Quigley, Member of Congress

The Honorable Peter Roskam, Member of Congress

The Honorable Bobby Rush, Member of Congress

The Honorable Jan Schakowsky, Member of Congress

The Honorable Aaron Schock, Member of Congress

The Honorable John Shimkus, Member of Congress

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