Federal Housing Finance Agency
Notice of Proposed Rulemaking (12 CFR Part 1263)
RIN 2590-AA39

We appreciate this opportunity to offer comments concerning the Notice of Proposed Rulemaking by the Federal Housing Finance Agency ("FHFA") as identified by RIN 2590-AA39, hereinafter referred to "the NPR". We are in substantial agreement with the NPR. However, we believe minor, but important, clarifications are necessary to ensure that the Federal Home Loan Banks ("Banks") have sufficient latitude to determine the character of all *home mortgage loan* assets without limiting reliance to regulatory accounting classification.

The modern mortgage finance market includes numerous assets designed to meet the needs of different classes of investors; and member institutions of the Banks ("Members") have evolved to create and/or invest in a variety of such assets that are essentially *home mortgage loans* or undivided interests therein. The Members require the Banks' financial support of all such residential mortgage lending activities that contribute to a liquid, efficient, competitive, and resilient national housing finance market. <u>We do not believe it would be beneficial, and in fact, we believe it would be harmful to the national housing finance market for the FHFA to be overly prescriptive in defining what specific activities or assets constitute residential mortgage lending activities or to not specifically allow the Banks to consider all relevant sources of information in making their determinations</u>.

The NPR seeks to establish a quantitative standard for determining compliance with the "makes long-term home mortgage loans" requirement under the Federal Home Loan Bank Act ("Bank Act"). In conjunction with its proposal to require an applicant or Member to maintain a specified percentage of its total assets in *home mortgage loans*, FHFA is also proposing to expand the list of assets that qualify as "home mortgage loans" to include all types of mortgage-backed securities ("MBS") that are fully backed by first mortgage loans on single- or multi-family property or by other securities that are fully backed by such loans. <u>We concur with the FHFA that for purposes of determining compliance with the "makes long-term home mortgage loans" requirement that the type of assets qualifying as "home mortgage loans" should be sufficiently broad so as to reflect the diversity of asset classes that comprise the modern housing finance market</u>.

As noted in the NPR, *the text of the Bank Act and its legislative history indicate that Congress intended to reserve the benefits of Bank membership, including access to low cost funding and the receipt of dividends on Bank stock, for institutions that are likely to use those benefits to fulfill the primary purposes of the Bank Act*. Title 12 defines *the mission of the Banks is to provide to their members and housing associates financial products and services, including but not limited to advances, that assist and enhance such members and housing associates financing: (a) financing of housing, including* *single-family and multi-family housing serving consumers at all income levels; and (b) community lending.*[1] Among the core mission activities of the Banks is to make advances to Banks' members.[2]

The NPR notes that *in the Housing and Economic Recovery Act of 2008, Congress amended the Federal Housing Enterprises Financial Safety and Soundness Act of 1992 ("Safety and Soundness Act") to establish FHFA as supervisor and regulator of the Banks, as well as Fannie Mae and Freddie Mac, and vested in its Director general authority over those regulated entities*. Further, *Section 1313 of the Safety and Soundness Act charges the Director with several specific duties, including the duties to ensure that: "the operations and activities of each regulated entity foster liquid, efficient, competitive, and resilient national housing finance markets"*.

The NPR cites *the primary purpose of the Bank Act, since its initial adoption in 1932, has been to support the nation's housing markets by establishing a system of Banks to provide wholesale funds to their member institutions for the purpose of financing those members' residential mortgage lending activities*.

The Bank Act defines the term "home mortgage loan" to mean a loan made by a Member upon the security of a home mortgage.[3] In turn, the statute defines the term "home mortgage" to mean a first mortgage, or its equivalent, upon real estate on which one or more homes or dwelling units are located.[4] The regulation supplements the statutory definition of "home mortgage loan" by defining the term generally to include any loan or interest in a loan that is secured by a first lien mortgage or any mortgage pass-through security that represents an undivided ownership interest in such loans or in another security that represents an undivided ownership interest in such loans.[5] The NPR affirms that *early in the history of the Bank System, the FHLBB determined that an institution's purchase of mortgage loans was the equivalent of "making" such loans for purposes of complying with the "makes long-term home mortgage loans" requirement*.

In effect, the current regulation distinguishes between (i) MBS that provide the holder with a <u>pro rata</u> ownership interest in each of the loans in the underlying pool of mortgage loans, and (ii) MBS that give the holder only a right to a specified portion of the cash flows generated by the underlying pool of mortgage loans.[6] The NPR proposes to bring within the definition of "home mortgage loan" all types of MBS. <u>We concur that Members should have the latitude to determine what type of MBS best suites</u>

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[1] §1265.2

[2] §1265.3

[3] 12 U.S.C. 1422(4).

[4] 12 U.S.C. 1422(5).

[5] Federal Housing Finance Agency, 12 CFR Part 1263, RIN 2590-AA39 (12 CFR 1263.1).

[6] Federal Housing Finance Agency, 12 CFR Part 1263, RIN 2590-AA39.

the needs of their stakeholders and that their choice of asset classes in general should not influence Bank membership so long as such assets continue to support residential mortgage lending activities.

In the current financial markets, investors recognize that all types of MBS essentially represent a right to some portion of the cash flows from the underlying mortgage loans. Whether, for example, the holder of the security has an undivided ownership interest in the underlying pool of mortgage loans, or has a beneficial ownership interest in the trust holding the mortgages, or has a contractual right to a specified portion of the cash flows generated by the underlying mortgages will vary depending upon the type of payment, risk, and maturity characteristics the issuer is attempting to achieve. The economic interest of all such instruments is much the same, and the forms of the respective instruments are more of a legal technicality that is neither decisive as to the nature of the economic interest that the owner holds nor the level of support for the mortgage market that the securities provide. (emphasis added) Indeed, the availability of the many types of MBS with different characteristics that have evolved to meet investors' needs over the past several decades has made the secondary mortgage market much more liquid. In recognition of this, FHFA believes that it is appropriate to expand the definition of "home mortgage loan" to include all types of MBS backed by qualifying assets and eliminate the current distinction that the rules draw between pass-through securities and other types of MBS.[7] We concur that numerous types of MBS and other debt and security instruments can be reflective of the Members' support of the mortgage market. Banks should be allowed specific latitude to consider Members' audited financial statements, certifications from Members' auditors, legal opinions and any other source of information deemed relevant by the Banks to determine the character of a specific asset or asset class.

The NPR acknowledges *that in cases where an institution has substantial mortgage banking operations* – i.e., it originates or purchases loans for resale rather than for portfolio – *its year-end balance sheet for any given year may not fully reflect its support for housing finance if it originated a substantial amount of home mortgage loans during the year that were then sold prior to year-end*. The NPR notes that *although the FHFA is proposing to use one percent of total assets as the standard for compliance with the "makes long-term home mortgage loans" requirement, it also believes that it could establish a higher percentage without either supplanting the "10 percent" requirement or unduly burdening a significant number of existing members*. *The agency will continue to consider whether to establish the standard at some higher percentage, such as two percent, or possibly as high as five percent, as part of this rulemaking.* We believe that mortgage banking operations represent a critical component to a liquid, efficient, competitive, and resilient national housing finance market. And, we believe that volume of mortgages originated, purchased or facilitated is a much more meaningful measure of a Member's support of the mortgage finance industry versus a period-end balance sheet total (even if the latter is determined as an average of multiple years' period-end balances). Therefore, we believe

[7] Federal Housing Finance Agency, 12 CFR Part 1263, RIN 2590-AA39.

Banks should have the latitude to consider Members' investment in "home mortgage loans" to include flow volumes as a percentage of assets.

Proposed §1263.11(b) specifies the required sources of data for both the "makes long-term home mortgage loans" and "10 percent" asset ratio calculations. In cases where that data does not show the institution to be in compliance, a Bank would be permitted to accept a written certification from the institution's external auditor stating the actual amount of the relevant assets held by the institution on the appropriate dates and to use those figures as the basis for its calculation. Further, the NPR acknowledges that *because regulatory financial reports are subject to change by the financial institution regulators, FHFA expects that it will need to issue guidance periodically to address any questions about how the Banks are to extract the relevant data from those reports*.

Just as ownership of numerous varieties of MBS can reflect Members' investment in and support of residential mortgage lending activities, other debt instruments that reflect Members' undivided ownership of or interest in residential mortgage loans should be allowed for purposes of a Member's meeting any percent of total assets standard for compliance with the "makes long-term home mortgage loans" requirement. Because regulatory accounting requirements and classifications are subject to change and may not clearly represent the true legal or contractual substance of an asset, the Banks should be allowed significant latitude to interpret Members' audited financial statements and to accept written explanations from Members' auditors and/or legal counsel to confirm the character of certain assets as representing ownership of or undivided interest in residential mortgage loans.

Again, we appreciate this opportunity to offer our comments.

Respectfully submitted,

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