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Sent via FHFA Web Portal:
www.fhfa.gov/open-for-comment-or-input
Copy to: RegComments@fhfa.gov

Subject: Federal Home Loan Bank Membership – RIN 2590-AA39

Dear Mr. Pollard:

The Washington State Department of Financial Institutions Division of Banks writes this letter by way of official comment to the notice of proposed rulemaking dated September 12, 2014 ("Proposed Rule"), of the Federal Housing Finance Agency ("FHFA"), which seeks to amend the Federal Home Loan Bank ("FHLB") membership requirement under the authority of the Housing and Economic Recovery Act of 2008.

The Proposed Rule changes the FHLB membership requirements *from* demonstrating at least one percent (1%) of assets in long-term home mortgages at the time of joining a FHLB *to* requiring a one percent (1%) minimum on an ongoing permanent basis ("One Percent Test"). Second, the Proposed Rule also requires that ten percent (10%) of a member's assets be in residential mortgage loans in order to maintain membership ("Ten Percent Test"). Third, the Proposed Rule changes the definition of "insurance company" for purposes of FHLB membership. We believe that each of these changes is unnecessary and is counter-productive to the mission of the FHLB system, and more importantly, counter-productive to the current efforts of the federal and state bank regulators.

The services that the FHLBs provide, including advances and match-funding of long-term loans, are critical components of a community bank's liquidity. Without this source of liquidity, community banks will likely struggle to provide access to credit within their local communities. The FHFA's Proposed Rule would have a detrimental effect on FHLB members and the FHLB system as a whole. Specifically, the proposed One Percent Test and Ten Percent

Test could lead to many community banks losing their FHLB membership or increasing their interest rate risk in an effort to avoid losing their FHLB membership.

The One Percent Test and Ten Percent Test

The proposed One Percent Test and Ten Percent Test are arbitrary. They provide no credit for offering or originating mortgage loans sold into the secondary market. The proposed requirements are contrary to the safety and soundness efforts currently being put forth by federal and state bank regulators to improve liquidity and to mitigate interest rate risk in the banking system. At a time when one of the highest concerns by bank regulators is interest rate risk, the FHFA is proposing to require an increase in the amount of long-term assets held by FHLB-member banks or face the loss of their FHLB membership. FHFA should ensure that any new regulations imposed on community banks are necessary for safety and soundness reasons, particularly in a recovering economy.

The Proposed "Insurance Company" Definition

The FHFA's proposed definition of "insurance company" will exclude "captive insurance companies" from membership eligibility. This part of the Proposed Rule is based on the FHFA's contention that for purposes of accessing FHLB funding, "captive insurance companies" may be formed by other companies, such as real estate investment trusts ("REITs"). We agree that REITS should not be allowed to use "captive insurance companies" to access FHLB advances. In our view, given that they are uninsured, REITs pose unnecessary risks to the FHLB system. Moreover, given that they are already tax-preferred entities, REITS call into question the public policy being served by giving them access to liquidity and lower costing funds.

Nevertheless, the FHFA should exercise discretion in determining the purpose of a particular application for membership by a "captive insurance company" rather than eliminating its membership altogether. If the Proposed Rule moves forward, it ought to be amended by FHFA to allow only the membership of "captive insurance companies" who serve the purposes of otherwise traditional eligible members. Use of "captive insurance companies" to create membership in more than one FHLB, particularly by institutions that now have substantially higher liquidity requirements than in the past, should be permitted. This would not only help to serve the industry's liquidity needs, but would reduce the concentration risk posed by large institutions belonging to only one or two FHLBs.

Conclusion

We support existing FHLB membership regulations, which ensure that there is a connection between members' holdings and borrowings. FHFA should ensure that its oversight of the FHLB system does not threaten continued membership, nor run contrary to the efforts of the federal and state bank regulators to ensure a safe and sound banking system. For all of the reasons set forth above, we strongly urge that FHFA not proceed with the Proposed Rule.

Respectfully submitted,

WASHINGTON STATE DEPARTMENT OF
FINANCIAL INSTITUTIONS

DIVISION OF BANKS

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