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January 8, 2015

Mr. Alfred M. Pollard, General Counsel
Attention: Comments/RIN 2590-AA39
Federal Housing Finance Agency
400 Seventh Street SW
Washington, DC 20024

RE: Notice of Proposed Rulemaking (NPR) and Request for comments-Members of the FHLBanks (RIN 2590-AA39).

Dear Mr. Pollard:

I am writing on behalf of the Vermont Department of Financial Regulation to comment on the Federal Housing Finance Agency's (FHFA) notice of proposed rulemaking (NPRM) regarding members of the Federal Home Loan Banks (FHLBanks). Vermont is home to nearly 600 captive insurance companies, a handful of which have joined the FHLBank system. Our interest in submitting comments is based upon Vermont's longstanding reputation as a global leader among captive insurance regulators. Our regulatory environment is the standard upon which many other states have modeled their captive insurance legislation. Our regulatory system, based in large part upon standards developed by the National Association of Insurance Commissioners, is designed to safeguard the solvency of captive insurers while recognizing the special purpose for which they were created.

The NPRM proposes to redefine the term "insurance company" to exclude captive insurance companies from membership in the FHLBanks. The Federal Home Loan Bank Act states in part that any insurance company "...shall be eligible to become a member of a Federal Home Loan Bank if such institution—

- (A) is duly organized under the laws of any State or of the United States;
- (B) is subject to inspection and regulation under the banking laws, or under similar laws, of the State...; and
- (C) makes such home mortgage loans as, in the judgment of the Director, are long-term loans..."



Captive insurers are certainly “duly organized under the laws of” their state of domicile.

Like traditional insurers, captive insurance companies are regulated by their respective state insurance departments and held to similar standards as other insurance companies. The regulations are commensurate with the limited purpose of the captive, and therefore may not include such particulars as regulatory review of policy rates and forms, as they are unnecessary when policyholders own the insurer. Otherwise, the regulation of captives is much the same and includes licensing requirements, capital and surplus standards, annual or quarterly financial reporting requirements for the captive *and parent*, annual CPA audits, regular department examinations and investment restrictions. In certain areas, such as approval of dividends, the captive regulation is actually more restrictive. There should be no doubt that captive insurance companies are regulated entities. In Vermont, captive insurance companies are subject to examination every 3 to 5 years; they are indeed “subject to inspection and regulation under the banking laws, or under similar laws, of the State”.

Based on current regulations, which deems a holder of mortgage securities to be a maker of long-term loans, captive insurance companies meet that eligibility standard as well.

There is nothing in the Federal Home Loan Bank Act that restricts membership of an otherwise eligible company based on its ownership or family relationships.

Not all captives are going to fit an ideal picture of what a FHLB member should look like. Since FHLB membership is quite broad, surely some existing non-insurance members don't meet the ideal. That's not enough reason to eliminate an entire category of business. Each captive is unique. Captives have a very marked tendency to be over-capitalized and operated very conservatively. They exist to pay the claims of their owners, and the owners (and the regulators) expect the captives to be able to meet their obligations. Captive owners represent the entire spectrum of American business. 42 of the Fortune 100 companies have captives in Vermont, as do a number of family businesses large and small. Each individual captive member may present a risk to the bank, as each individual “traditional” member would, but captives as a group or class do not present any untoward risk. Properly underwritten, Captives present an opportunity for the FHLBanks to diversify their portfolios, strengthening the system as a whole.

In the NPRM, the FHFA is attempting to redefine insurance company to eliminate the eligibility of captive insurance companies. The definition in the proposed rule (companies whose primary business is underwriting of insurance for nonaffiliated persons or entities) will not necessarily exclude all captives, as many write insurance for non-affiliates, and may exclude some traditional insurance companies that are currently eligible. Without going to individual state statutes, it is very difficult to define a captive, and the proposed definition is ambiguous.

The FHFA also notes that financial information on captives may be difficult to obtain. Captives are subject to the same conservative FHLBank membership, collateral, and credit rules as other members. FHLBanks have the ability and experience to monitor and underwrite the financial strength of insurance companies and captives, and collateral requirements allow the FHLBanks to secure advances that safeguard FHLBanks from potential losses. Financial information of the captive, and in some cases the parent, is held confidential by regulators. That does not mean it is

out of the reach of the FHLBank. If the bank cannot get access to the necessary financial information, it need not, and should not, make any advances. FHFA and its predecessor agency, the Federal Housing Finance Board have appropriately applied by regulation the “financial condition,” “character of management,” and “home financing policy” requirements to all institutions as a matter of safety and soundness, and should continue to do so.

Captives seeking FHLBank membership must have a demonstrated commitment to housing finance. Like any traditional insurance company, Captives can play a significant role in providing or investing in residential mortgage assets, providing much needed liquidity which is critical to housing markets. In today’s economic environment, when housing is so important to economic recovery, captives should be welcomed into FHLBank membership due to their important role in housing finance. Some captive parents are directly involved in housing finance and construction, while others meet the FHFA “makes loans” requirements by virtue of significant investment in housing-related securities.

As with traditional insurers and other FHLBank members, captives have found that membership in the FHLB system provides a reliable source of liquidity. Like any other insurer, a captive can find itself in a position of having to pay a large claim before receiving the related reinsurance payment. FHLB membership allows the company to borrow short-term funds rather than be forced to liquidate a portion of a long-term portfolio. Such a business purpose does not seem antithetical to the goals of the FHLB system, and sensible and prudent from the point of view of the insurance company regulator.

On behalf of the Vermont Department of Financial regulation, I urge the FHFA to withdraw the proposed rule. It may be that reasonable qualitative measures could be applied to the membership, such as seasoning requirements, minimum capital levels, maximum leverage ratios, independent ratings, etc., as long as such requirements are applicable to all insurers equally. The FHFA will still have to address the many comments that assert that the FHFA does not have authority to change the definition in the first place.

Sincerely,



David F. Provost
Deputy Commissioner, Captive Insurance