



1201 15th Street NW  
Washington, DC 20005

T 800 368 5242  
F 202 266 8400

www.nahb.org

David L. Ledford  
Senior Vice President

January 9, 2015

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

Re: Members of Federal Home Loan Banks  
Notice of Proposed Rulemaking; Request for Comments

Attention: Comments/RIN 2590-AA39

Submitted via Electronic Delivery to:  
[www.fhfa.gov/open-for-comment-or-input](http://www.fhfa.gov/open-for-comment-or-input)

Dear Mr. Pollard:

On behalf of the National Association of Home Builders (NAHB), I appreciate the opportunity to respond to the Federal Housing Finance Agency's (FHFA) Notice of Proposed Rulemaking (NPR); Request for Comments on the proposed revisions to regulations governing Federal Home Loan Bank (FHLBank) membership. The FHLBanks play a critical role in providing liquidity to the housing finance market. Changes to any aspect of how the FHLBanks are regulated must be considered carefully to avoid unintended and potentially harmful consequences to the FHLBanks, their members and the housing finance system.

NAHB is a Washington-based trade association representing more than 140,000 members involved in all aspects of single family and multifamily residential construction. The ability of the home building industry to meet the demand for housing, including addressing affordable housing needs, and contribute significantly to the nation's economic growth is dependent on an efficiently operating housing finance system that offers home buyers access to affordable mortgage financing at reasonable interest rates through all business conditions. NAHB believes a sound and successful FHLBank System is a key element for reaching these goals.

### **Background**

FHFA was created by the Housing and Economic Recovery Act of 2008 as the successor agency to the Office of Federal Housing Enterprise Oversight and the Federal Housing Finance Board. The agency was granted regulatory authority over Fannie Mae, Freddie Mac and the FHLBank System. As the regulator of the individual FHLBanks and the FHLBank System, FHFA establishes the regulations required to carry out the statutory provisions of the Federal Home Loan Bank Act (FHLBank Act).

## **Proposed FHLBank Membership Eligibility**

The primary provisions of the NPR are as follows:

- 1) The NPR would require an institution to have at least one percent of its total assets in long-term home mortgage loans at the time of its FHLBank membership application and to maintain the one percent ratio of home mortgage loans to total assets on an ongoing basis in order to retain its FHLBank membership. In addition to counting first lien mortgage loans on one-to-four and multifamily properties, the NPR proposes to broaden the types of mortgage-backed securities (MBS) that can be counted toward the one percent requirement. Mortgage-backed securities will now include all types of MBS that are fully backed by whole loans that meet the definition of home mortgage loan (i.e. collateralized mortgage obligations (CMOs), real estate mortgage investment conduits (REMICs), and principal-only and interest-only strips) rather than only mortgage pass-through securities. Compliance with the standard would be determined based on the average amount of home mortgage loans held at the three preceding year-ends.

*The current regulation requires that an institution “originates or purchases” long-term home mortgage loans. The current requirement neither specifies a specific percentage of total assets that must be held as home mortgage loans nor does it call for an institution to prove it continues to make or purchase home mortgage loans after it becomes a FHLBank member.*

- 2) The NPR would require all insured depository institutions to have at least 10 percent of total assets in residential mortgage loans at the time of its FHLBank membership application and to maintain 10 percent of its assets in residential mortgage loans on an ongoing basis in order to remain eligible for FHLBank membership. The NPR makes no changes to the definition of “residential mortgage loan” which remains defined as all assets that qualify as home mortgage loans, plus loans secured by junior liens on one-to-four family property or multifamily property; loans secured by manufactured housing; funded residential construction loans, and mortgage pass-through securities representing an ownership interest in, or mortgage debt securities secured by, any of those types of assets.

The proposed rule exempts from the 10 percent requirement any institution that is not currently subject to that requirement (due to being a FHLBank member as of January 1, 1989) and any FDIC-insured depositories with less than \$1.108 billion in average total assets over the preceding three years, i.e. Community Financial Institutions (CFIs).<sup>1</sup> Compliance with the standard would be determined based on the average amount of residential mortgage loans held at the three preceding year-ends.

*As mandated in the statute, the current regulation requires an FDIC-insured institution with \$1.108 billion or greater in average total assets over the preceding three years to have 10 percent of total assets in residential mortgage loans when applying for membership with a FHLBank. Neither the statute nor the current regulation requires the institution to continue to hold 10 percent of its total assets in residential mortgage loans*

---

<sup>1</sup> CFI is defined as an FDIC-insured depository community financial institution with less than \$1 billion in average total assets over the preceding three years. Per the FHLBank Act, the \$1 billion is adjusted annually for inflation and currently is \$1.108 billion.

*after becoming a FHLBank member. FDIC-insured institutions with less than \$1.108 billion in average total assets are exempt from the requirement. Credit unions, regardless of total assets, are not exempt from the 10 percent requirement unless they were members of a FHLBank as of January 1, 1989.*

- 3) The NPR would limit the types of insurance companies that are eligible for FHLBank membership by defining the term “insurance company” to include only those companies whose primary business is the underwriting of insurance for nonaffiliated persons or entities. This effectively would eliminate the option of FHLBank membership for captive insurance companies.

*The current regulation allows FHLBank membership, as listed in the FHLBank Act, for three categories of institutions; 1) FDIC- or NCUA-insured depository institutions; 2) insurance companies; and 3) community development financial institutions. Currently, there is no restriction on the type of insurance company that is eligible for FHLBank membership.*

- 4) The NPR would establish more robust standards for a FHLBank to determine if an insurance company is in such financial condition that advances may be safely made to it. The NPR would require a FHLBank to review an insurance company’s most recent audited financial statements and to determine that its financial condition is such that the FHLBank can safely make advances to it.

*Currently, FHLBanks review information in an insurance company’s most recent regulatory financial report only to confirm that it meets all of its minimum statutory and regulatory capital requirements.*

- 5) The NPR would revise the existing language in the FHLBank Act to clarify that an institution may only be a member of the FHLBank of the district in which the institution has its principal place of business. Further, the institution would be required to conduct business operations from the home office in order for that state to be considered its principal place of business. An insurance company that may have trouble satisfying the requirements for determining its principal place of business would be required to conduct business operations from its “home office” as designated by its charter or articles of organization.

Currently, the regulation provides that an institution’s principal place of business for FHLBank membership purposes generally is deemed to be its “home office” if designated by its charter or articles of organization, but there is no requirement that business actually be conducted from that designated location.

### **NAHB Comments on Proposed FHLBank Membership Eligibility**

More than 7,500 member institutions rely on the FHLBanks to provide a stable source of funding for residential mortgage and community development lending activities. In order to access funds for residential mortgage lending and community development lending activities, (i.e. “advances”), FHLBank member institutions must pledge collateral in the form of single family and multifamily originated or purchased mortgage loans; single family and multifamily mortgage-backed securities, mortgage-backed securities issued, insured or guaranteed by the U.S. government, including Fannie Mae, Freddie Mac and Ginnie Mae securities; certain other

**Federal Housing Finance Agency  
Notice of Proposed Rulemaking  
Members of Federal Home Loan Banks  
January 9, 2015  
Page 4**

collateral that is real estate-related and certain other qualifying securities, i.e. commercial real estate loans and commercial real estate mortgage-backed securities; and cash or deposits in the FHLBank.

NAHB appreciates that FHFA, through this NPR, is trying to make sure FHLBank members are using their FHLBank advances to engage in home mortgage and residential mortgage lending as defined by FHFA in the NPR. It is in NAHB's members' best interests to have a FHLBank System that is strong and viable and is a reliable source of funding for institutions that utilize the System to finance housing and economic development. NAHB's members rely on the FHLBank member institutions in their communities for acquisition, development and construction (AD&C) lending, mortgage lending to consumers and community development funds.

However, in the NPR, FHFA recommends revisions and clarifications to the existing eligibility requirements for FHLBank membership that NAHB believes would make it harder for some depository institutions to become members of a FHLBank and for others to maintain their FHLBank membership while also imposing an elevated level of regulatory oversight by the FHLBanks to make the necessary eligibility determinations. The NPR also would prohibit FHLBank membership for some institutions that currently are allowed membership. In their entirety, NAHB is concerned the proposed changes would have a negative impact on the availability of housing credit through the FHLBank System and lead to decreased liquidity in the housing finance market as they purport to correct a problem even FHFA acknowledges is not significant.

Though FHFA does not believe its proposal would immediately impact a large number of banks, savings associations, credit unions or captive insurance companies, NAHB believes this view is shortsighted and FHFA has not adequately assessed the potential long-term consequences of the NPR.

NAHB is opposed to requiring FHLBank members to meet the “makes home mortgages” and “holds 10 percent of total assets in residential mortgages” standards on a continuous basis.

The new quantitative “makes home mortgages” test requiring all FHLBank applicants and member institutions to hold one percent of assets in long-term home mortgage loans at the time of application and on a continuous basis and the ongoing “10 percent of total assets held in residential mortgages” test are unnecessary to ensure FHLBank member institutions’ commitment to housing and may deter would-be applicants. Both requirements would increase regulatory compliance costs to the FHLBank System and create uncertainty regarding long-term FHLBank membership.

All applicants seeking membership with a FHLBank always have been required to show that their institutions make long-term home mortgage loans. Depositories, other than CFIs, have been required, additionally, to have at least 10 percent of their total assets in the broader category of residential mortgage loans. FHLBank members are effectively incented to continue to hold home mortgage loans and residential mortgage loans because this allows them access to low-cost funds known as advances – one of the most significant and valued benefits of belonging to a FHLBank.

**Federal Housing Finance Agency  
Notice of Proposed Rulemaking  
Members of Federal Home Loan Banks  
January 9, 2015  
Page 5**

In order to borrow from its FHLBank, a member must have residential housing finance assets<sup>2</sup> in its portfolio as collateral against the advance. A FHLBank will not make long-term advances to a member if the principal amount of all long-term advances is greater than the value of its residential housing finance assets. NAHB believes the Residential Housing Finance Asset test makes it unnecessary for FHLBanks to be required by regulation to monitor their members' residential housing assets on an ongoing basis because the FHLBanks necessarily will determine the presence of residential housing assets when deciding whether to make long-term advances and calculating the amount of long-term advances that may be approved. Though it is allowable for a member to pledge cash or deposits held at its FHLBank as collateral against advances, and for CFIs to pledge loans secured by small businesses, agriculture and community development, 95 percent of collateral securing advances is real-estate related. As of year-end 2013, whole mortgage loans comprised 72 percent of collateral pledged against advances.<sup>3</sup>

To require FHLBank members to hold a specific amount of residential mortgage assets on an ongoing basis effectively would require FHLBanks to regulate their members. Not only would this monitoring impose a regulatory burden on the FHLBanks on an annual basis and more frequently if an institution is found to be non-compliant, but it would require them to interfere with the business decisions of their members. There may be business goals or reasons related to current economic or industry conditions that prevent a financial institution from being in compliance with the one percent and 10 percent requirements. Trying to meet these standards may cause financial institutions to manage their balance sheets in a way that, ultimately, is not in their best interests.

For example, a merger or an acquisition may be in the best interests of a bank that wants to grow or a struggling bank. However, the outcome of the consolidation might put the resulting organization in a position in which it suddenly would become subject to the requirement to have 10 percent of assets in residential mortgage loans – a requirement to which neither institution previously had been subject. While the consolidated institution would have some time to reach the 10 percent level, this may not be achievable in a practical or fiscally sound manner, perhaps causing a bank to forego or delay a decision in its financial interest.

Too, the element of uncertainty as to whether an institution's eligibility for FHLBank membership could be in jeopardy at any time for failing to meet the required asset levels could deter new membership. Though FHLBank member institutions that fall out of compliance with the standards have a significant timeframe in which to return to compliance, for some institutions ongoing uncertainty around their eligibility status may be a burden they will not want to bear. NAHB believes FHFA should be seeking to support and encourage membership in the FHLBank System rather than imposing rules that may lead institutions to decide it is too onerous to join a FHLBank or maintain a FHLBank membership.

---

<sup>2</sup> As defined in 12 CFR 950.1: Residential Housing Finance Assets are 1) Loans secured by residential real property; (2) Mortgage-backed securities; (3) Participations in loans secured by residential real property; (4) Loans or investments qualifying under the definition of "community lending" in § 900.1 of this chapter; (5) Loans secured by manufactured housing, regardless of whether such housing qualifies as residential real property; or (6) Any loans or investments which the Finance Board, in its discretion, otherwise determines to be residential housing finance assets.

<sup>3</sup> [Report on Collateral Pledged to Federal Home Loan Banks](#). November 2014, Pg. 6

**Federal Housing Finance Agency  
Notice of Proposed Rulemaking  
Members of Federal Home Loan Banks  
January 9, 2015  
Page 6**

In the NPR, FHFA cites the following statistics based on call reports filed with the Federal Financial Institutions Examination Council as of December 31, 2013: 1) Of 5,976 commercial banks and savings associations that were FHLBank members, 47 would have failed to meet the one percent home mortgage loans-to-total assets ratio, and 2) Of 1,719 commercial banks, savings associations and credit unions subject to the “10 percent of assets” test, 52 would have failed to comply.

FHFA offers these statistics and others to demonstrate that it believes the proposed rule would have such an inconsequential effect that it should not be opposed. However, NAHB believes the numbers make the opposite, more compelling point: So few institutions would be impacted, the proposed rule is unnecessary. Also, it is unknown from analyzing the potential impact on current FHLBank members, how many institutions may choose not to apply for membership, deterred by the possibility that a changing business focus or unpredictable economic conditions could affect their future access to FHLBank advances even if membership might have been approved based on an institution’s current financial condition.

FHFA does not propose to count flow business as “makes home mortgage loans”. NAHB believes this would be an oversight. The FHLBanks have made significant progress in increasing access to the secondary market for their members – especially small banks and credit unions – and many institutions have been utilizing the secondary market to reduce their mortgage portfolios in response to capital and other regulatory requirements. The FHLBanks have developed and promoted programs such as MPF and MPF Xtra to allow their members to originate and sell loans in the secondary market. Other new programs are being tested by the FHLBank of Chicago that will allow member institutions to originate and sell government-insured and government-guaranteed mortgages and jumbo mortgages.

NAHB believes the test of “makes long-term home mortgage loans” is too narrow and should incorporate some way to count originations. NAHB recommends that FHFA establish a mechanism to apply some amount of originations sold in the secondary market toward the “makes home mortgages” test rather than count only loans on the balance sheet at the time of the one percent test.

NAHB is opposed to prohibiting FHLBank membership for captive insurance companies.

Prohibiting FHLBank membership eligibility for captive insurance companies arbitrarily eliminates an increasingly important source of mortgage liquidity and makes a membership decision that should be made by Congress.

FHFA cites general safety and soundness concerns for planning to exclude captive insurance companies from FHLBank membership eligibility. However, FHFA gives no specific evidence of harm to the FHLBank System and only notes that captive insurers present risk to the System because the FHLBanks do not have access to the same financial and supervisory information on captive insurers or their parent companies that is available to them on their depository institution members. The financial statements filed by insurance companies with their state insurance regulators generally are not available to the public or even to other state insurance regulators.

NAHB believes eliminating captive insurers from the FHLBank System would harm the housing market at a critical time in its recovery. Captive insurance companies formed by Real Estate Investment Trusts (REITs) have access to FHLBank advances that can be used by the REITs to

**Federal Housing Finance Agency  
Notice of Proposed Rulemaking  
Members of Federal Home Loan Banks  
January 9, 2015  
Page 7**

fund activities in the mortgage finance system. REITs are not allowed to join FHLBanks and, therefore, cannot access FHLBank funds directly.

Mortgage REITs (mREITs) use the funds obtained by the captive insurers to originate or purchase mortgage loans, mortgage-backed securities (MBS), mezzanine loans, subordinated financing, and construction loans. Mortgage REITs invest in residential and commercial mortgages, as well as residential and commercial MBS. Residential mREITs may have an agency focus, investing in Fannie Mae, Freddie Mac and Ginnie Mae MBS, or a non-agency focus, investing in private label MBS and whole loans that do not meet the guidelines of Fannie Mae and Freddie Mac.

FHFA acknowledges that mREITs are participants in the residential housing finance market and their business activities are not outside the scope of the purpose of FHLBank advances. However, FHFA still believes the current trend of FHLBank membership by captive insurance companies and their borrowing for the benefit of their REIT parents disregards and circumvents the intent of Congress not to allow REITs FHLBank membership.

Regardless of FHFA's desire to close this purported loophole, the fact remains that insurance companies are allowed membership into FHLBanks, by statute, and captive insurance companies are insurance companies. As FHFA has pointed to no convincing evidence that captive insurers pose a danger to the System, NAHB does not believe FHFA should prohibit them from FHLBank membership. If FHFA has identified specific safety and soundness concerns to the FHLBanks from membership of captive insurers, a less dramatic approach to mitigating those concerns than outright denial of their membership should be considered – such as supervisory actions as needed.

To-date, mREITs hold a very small percentage of the agency MBS market and a small, but growing, percentage of multifamily mortgage debt. As portfolio lenders continue to reduce mortgage holdings and the market increasingly seeks to become less dependent on the federal government and Fannie Mae and Freddie Mac, mREITs offer the potential to increase the level of private mortgage capital in the housing finance market. Having FHLBank advances as a source of low-cost capital allows mREITs to provide pricing benefits to the housing market, home buyers and renters. For example, mREIT Redwood Trust Inc., in its second-quarter securities filing, said it had "utilized \$26 million of Chicago FHLBank advances to fund \$30 million of jumbo residential loans as of July 31, 2014. FHFA's proposal would stop Redwood's captive insurance subsidiary, RTW Financial LLC, from accessing advances from the FHLBank of Chicago.

Notably, captive insurance companies are a significant source of income to the FHLBank System. Interest income on advances to captive insurers benefits the FHLBank System and the housing market, generally.

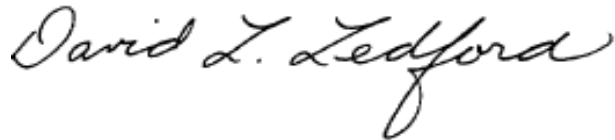
In today's challenging housing finance environment, NAHB believes FHFA should be seeking ways to support the return and increasing use of private capital for housing rather than proposing to limit financing options. NAHB recommends that FHFA work with the FHLBanks and insurers to identify a more acceptable resolution to FHFA's concerns.

## **Conclusion**

NAHB recommends that FHFA withdraw the NPR. It is unnecessary at best and negative for the industry at worst. As proposed, the requirements would introduce a level of uncertainty to the housing finance system by causing FHLBank members to manage their mortgage originations and balance sheets to meet FHLBank requirements rather than their business and market needs and would eliminate a growing source of private capital for housing finance.

Thank you for your consideration of NAHB's comments. If you have questions, please contact Becky Froass, Director, Financial Institutions and Capital Markets, at 202-266-8529 or [froass@nahb.org](mailto:froass@nahb.org).

Sincerely,

A handwritten signature in black ink that reads "David L. Ledford". The signature is written in a cursive style with a large, looping 'D' and 'L'.

David L. Ledford