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The Honorable Melvin L. Watt  
Director  
Federal Housing Finance Agency  
400 7th Street, SW  
Washington, DC 20024

**RE: NPR (RIN 2590-AA39) Will Exacerbate the Next Financial Crisis**

Dear Director Watt:

We are writing in response to the notice of proposed rulemaking (NPR) pertaining to membership in the Federal Home Loan Bank System (FHLBanks) that was issued by the Federal Housing Finance Agency (FHFA) on September 2, 2014 (RIN 2590-AA39).

We express our appreciation of your efforts to safeguard the FHLBanks and promote its mission fulfillment in a safe and sound manner through the issuance of the NPR.

However, despite its good intentions, the NPR is not consistent with longstanding Congressional intent, does not pass any objective cost/benefit analysis and has the potential for severe, unintended consequences that outweigh perceived benefits. The NPR also violates the principle of “do no harm” by changing rules that are working well, in a manner that will exacerbate the next financial crisis.

The severity of the NPR will far exceed the estimate of “less than 100 members (affected)” that you provided at a Senate Banking Committee hearing on November 19, 2014, because the estimate does not include the hundreds of firms that are currently eligible for FHLBank membership, including some of the largest residential mortgage owners and producers in the nation, that are actively contemplating FHLBank membership or have already applied for FHLBank membership and their applications were suspended as a result of the FHFA’s issuance of the NPR.

Additionally, FHLBank of Chicago President and CEO Matt Feldman said on September 15, 2014, “Our early estimate is that the proposed reg would eliminate between \$230 billion and \$350 billion of borrowing capacity just from the members that would have failed to qualify over the past five years and, as a result, would have become ineligible for FHLBank membership.”

Unintended consequences of the NPR include the loss of hundreds of \$ billions in mortgage liquidity, loss of investment and sponsorship in affordable housing and community development, decreased private investment in mortgages, reduced access by small financial institutions to secondary mortgage markets and global capital markets, and, in general, a reduction in access to emergency liquidity which has played a critical role in stabilizing the financial system during turbulent economic times.

Congress has acted not once since the enactment of the Bank Act in 1932 to curtail FHLBank membership and usage. While we are not advocating expansion of membership eligibility to include real estate investment trusts (REITs) and other new entity types, we also do not support rules that adversely affect the status of current and potential members by terminating or impairing the membership rights of firms presently in good standing, preventing currently eligible firms from becoming members, and potentially denying members access to liquidity when they need it most.

All insurance companies, including captive insurers, have without prejudice been eligible for membership since the Bank Act was signed in 1932, and we see no justification to redefine “insurance company” from its plain meaning to exclude captive insurers or redefine insurers’ principal place of business, or to appropriate the rights of states to define these terms as stipulated under the McCarran-Ferguson Act. Also, the corporate structure of a parent, whether it is a REIT or bank holding company, need not affect membership eligibility of its subsidiaries.

From a mission perspective, FHLBanks have commented that captive insurance members are among their best members in terms of mission fulfillment because captive members have a business plan and balance sheet that specifically focuses on production and ownership of high-quality mission-related residential and economic-development mortgage assets. This point is underscored by the following quote from a current captive insurance member of the FHLBank of Indianapolis:

*"The assets collateralizing these (FHLBank) advances are all mission-related. They're high quality, they're liquid. They generally have very conservative advance rates...and, importantly, the captive is regulated...so we believe our membership is good for housing, good for mortgage rates, good for the Home Loan Bank system. Our existence (as a FHLBank member) is a good example of a Company that's providing support for homeowners and for the taxpayer by playing a meaningful part in getting private capital to replace the government's role, or enhance the government's role."*

*-Rich King, CEO, Invesco Mortgage Capital Inc. (IVR)*

From a safety and soundness perspective, the FHLBanks stated there is no evidence or example to support the myth promulgated by the NPR that captive insurance regulators provide a "light regulatory touch." FHLBanks said they maintain close communications with state insurance regulators and require a greater degree of underwriting, transparency and reporting with respect to captive insurance companies and their parent organizations compared to banks and other insured depositories.

The NPR will actually compromise safety and soundness by amending rules that are working well, in a manner that will exacerbate the next financial crisis, increase systemic risks and destabilize capital markets. Current and potential captive insurers who are denied FHLBank membership will be forced to rely on increasingly unstable repo markets that are known to "dry up" in times of financial crisis, cause "fire sales" that exacerbate a financial crisis, and increase four (4) key areas of risk, as follows:

- 1) increase interest rate risk by preventing asset/liability match-funding as offered by FHLBanks
- 2) increase leverage
- 3) decrease asset credit quality, and
- 4) increase counter-party & liquidity risks

Lastly, the NPR incorrectly states, as a key argument to eliminate captive insurer membership, "When Congress authorized insurance companies to become Bank members in 1932, the concept of captive insurers was essentially unknown in the United States." Historical records indicate Congress was likely aware of the practice of captive insurance arrangements in 1932. The concept of captive insurance dates back to the 17th century when ship owners began meeting in Edward Lloyd's London coffee shop to discuss alternatives to insuring their ships and cargo. In the U.S., New England textile manufacturers formed a group similar to the Lloyd's syndicate to share risks due to high fire insurance rates in the 1800's. In 1929, the Episcopal Church formed the Church Insurance Company to cover risks associated with members, a story that was highlighted on the front page of the New York Times.

In light of the concerns expressed above, we urge you to reconsider the NPR and work with the FHLBanks and Congress to pursue a more balanced, appropriately targeted approach to address specific issues of concern to the FHFA.

Sincerely,

**HIGHPOINT REALTY CAPITAL, LLC**

*Michael Zukerman*

Michael B. Zukerman