FHLBBoston

January 9, 2015

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

Re: Notice of Proposed Rulemaking and Request for Comments -Members of Federal Home Loan Banks (RIN 2590-AA39)

Dear Mr. Pollard:

Thank you for the opportunity to comment on the recent Notice of Proposed Rulemaking regarding Federal Home Loan Bank ("FHLBank") membership referenced above (the "Proposed Rule") published by the Federal Housing Finance Agency (the "FHFA") on September 12, 2014.

We are perplexed by the Proposed Rule – both its legal underpinnings and its purpose – and believe that, if implemented, it would have an adverse effect on the FHLBanks, the housing finance market as a whole, and the communities served by our member financial institutions (both existing and prospective). We do not understand why the FHFA would propose a regulation that has the effect of narrowing long-standing membership eligibility rules, especially when **Congress itself has acted repeatedly to expand – but never to contract – eligibility for FHLBank membership**. As a result, we urge that the Proposed Rule be withdrawn.

The 10% and 1% balance sheet tests that the Proposed Rule would impose are especially troublesome. The FHFA concludes that these tests are "necessary" to avoid "the possibility that institutions having no significant past or future involvement in home mortgage lending may become and remain FHLBank members," but acknowledges that it "has found no evidence that the problem is widespread" [79 Fed. Reg. 54853]. Some have suggested that this is "a solution in search of a problem." The FHFA asserts in the preamble (based upon its own analysis) that "relatively few" FHLBank depository institution members would fail to meet the 10% test, and that a "vast majority" of such members would meet the 1% test. The preamble also downplays the impact of the 1% test on insurance company members. But the FHFA's focus on the immediate impact of these tests based on FHLBank members' current balance sheets fails to consider the long term adverse consequences of this proposal, including the potential reduction of contingent liquidity for U.S. depository institutions, for which the FHLBanks were "by far, the

largest lender" during the recent financial crisis. [Federal Reserve Bank of New York, Staff Report No. 357 at pages 28-29 (November, 2008)].

First, being required to monitor members' compliance with the tests will impose an additional burden on the FHLBanks, and create an increasingly regulatory relationship between the FHLBanks and their members. Congress removed the FHLBanks' regulatory role in 1989 with the passage of FIRREA, and it has taken many years for formerly regulated members to change their perception of the FHLBanks as another regulator. The Proposed Rule moves in the wrong direction.

Second, and most importantly, **we believe that the ongoing balance sheet tests will have the result of shaking the members' (and their regulators') confidence in the FHLBanks as a reliable source of liquidity in all economic cycles.** Even members that easily meet the eligibility tests today are legitimately concerned that:

- In the future, their balance sheet and risk management strategies could change in a manner that is at odds with their ability to maintain their FHLBank membership (for example, by selling rather than retaining in portfolio all of their residential mortgage loan originations), putting them in the position of choosing between optimal balance sheet management or continued access to the FHLBank as a source of liquidity;

- Once the FHFA takes the unprecedented step of introducing ongoing balance-sheet-based eligibility requirements, FHLBank members have no assurance that such requirements will not be subsequently increased or changed in a way that could adversely affect their ongoing membership (a valid concern, in light of the Proposed Rule's preamble, which suggests that other/higher levels for these tests are being considered); and

- The constriction and volatility of the FHLBanks' membership base resulting from *other* members' or prospective members' potential failure to pass the balance sheet tests will weaken the FHLBanks, making them a less reliable funding partner for *all* members and potentially reducing their income and thus their contributions to their Affordable Housing Programs.

Safe and strong financial markets are built on the foundation of the underlying confidence of market participants. Introducing uncertainty about whether financial institutions will be allowed to continue to belong to, and borrow from, a Federal Home Loan Bank will surely have a negative impact on the housing market, financial institutions, and the economy more broadly. If FHLBank members become worried, even slightly, about whether FHLBank funding might be unavailable when the members truly need it, they will understandably seek to shore up their

alternative sources of contingent liquidity, reducing the value of FHLBank membership and threatening the FHLBank System.

We also question the FHFA's rationale and authority for adopting a narrow definition of "insurance company" that is at odds with the statutory language making *"any"* insurance company eligible for FHLBank membership. While we understand certain of the concerns raised in the preamble to the Proposed Rule about captive insurance company membership, the approach that the Proposed Rule takes to this issue sweeps far too broadly. We believe that there should be a way of addressing legitimate concerns of safety and soundness and mission consistency without simply banning all captive insurance companies from FHLBank membership. We ask that the FHFA find a narrower and more focused approach to addressing safety and soundness and mission concerns, rather than overstepping the will of Congress, which is to make *all* insurance companies eligible for Federal Home Loan Bank membership. We would be happy to participate in such a discussion.

Without limiting our general view that the Proposed Rule uses too broad a brush in addressing the FHFA's concerns about captives, we think that one particular type of "captive" deserves special comment. Group or association captives (which are sometimes, but not always, federally licensed as risk retention groups), are organized by and underwrite insurance for groups of unrelated entities or individuals, typically companies in the same industry or members of the same trade association. Although organized under state captive insurance statutes, they are in many ways more similar to mutual insurance companies than to pure captives, in that they write insurance for multiple, unrelated policyholders/members. While the policyholders/ members together own the group/association captive, they are not "affiliates" of the captive like the parent of a pure captive is, particularly where the group/association captive has a large membership. In fact, the policyholder/members of a group/association captive are *analogous to the members of an FHLBank* – in both cases equity ownership is required as a condition of accessing products and services.

This type of insurance company does not lead to any of the concerns that the FHFA expressed about "captives" in the preamble to the Proposed Rule, such as the use of the captive to fund the activities of an ineligible parent, or the non-diversified risk of writing insurance solely for the parent. As a result, there is no rationale for excluding them from the FHLBank membership to which they are statutorily eligible under the Federal Home Loan Bank Act (the "FHLBank Act"). Accordingly, as part of any solution that the FHFA may adopt to address its concerns about captive insurers, we urge the FHFA to confirm that those concerns do not apply to group/association captives, and that, as companies whose primary business is underwriting insurance for multiple nonaffiliates, they are eligible for membership on the same basis as any other insurance company.

We have also given a lot of thought to the Proposed Rule's handling of "principal place of business" for insurance companies, and urge the FHFA to repropose changes to its existing membership regulation to address this issue after the Proposed Rule is withdrawn. We generally support the views of the vast majority of other FHLBanks expressed in comment letters submitted (or to be submitted) to you on this specific topic, and described in Exhibit A to this letter (the "Majority FHLBank Position").

With respect to captives, however, we have a different perspective from many of the other FHLBanks. To the extent that the FHFA modifies the approach taken in the Proposed Rule and does not generally exclude captive insurance companies[1] from membership eligibility (as we have requested above), we believe that there are legitimate distinctions between captives and other types of insurance companies that warrant a different principal place of business ("PPOB") analysis.

As captive insurance companies are often owned/organized by a parent that does not itself have insurance expertise, their insurance activities are typically managed through a contractual arrangement with an affiliate or a third party vendor, and their investment/funding activities are typically overseen by employees of an affiliate. As a result they may not have separate employees or physical presence of their own, and thus would be deemed to have their PPOB in the state of their domicile under the Proposed Rule. While we generally agree with the Proposed Rule's approach (endorsed in the Majority FHLBank Position) that traditional insurance companies without separate employees or physical presence should look to state of domicile for their PPOB, we believe that a different analysis is appropriate for captives.

Congress established the FHLBanks as regional cooperatives to serve defined geographic areas, with each depository institution, insurance company and CDFI eligible to join only the FHLBank located in the district where it maintains its PPOB. Enabling potential applicants to "shop" among the FHLBanks in determining which one to join is not contemplated by the FHLBank Act,[2] as the Act assumes that applicants will have already been organized and commenced operations in a location selected for the applicant's own business purposes, independent of its interest in FHLBank membership. This is generally true for traditional insurance companies (and for group/association captives). However, because captive insurance companies can be organized relatively easily in contemplation of applying for FHLBank

[1] For purposes of this section of the letter, we use the term "captive" to refer to companies that do not meet the definition of "insurance company" set forth in the rule. As noted above, we believe that group/association captives *do* meet that definition and therefore our comments about principal place of business for captives would not apply to them.

[2] Under the FHFA's regulations, the ability to "shop" among FHLBanks is only contemplated in limited circumstances where an applicant requests redesignation of its PPOB from its state of domicile to another state where it meets the three factor test.

membership, using a state-of-domicile PPOB test may encourage "shopping," or selecting a state of domicile solely for the purpose of accessing membership in a particular FHLBank. This may lead to a troubling situation where Federal Home Loan Banks are chosen for captive membership based on least restrictive collateral or stock purchase requirements, or lowest advance pricing, a situation that we expect that the FHFA would want to discourage.

To avoid this result, we suggest that the PPOB of captive insurance companies for FHLBank membership purposes be determined by reference to the principal place of business of the entity sponsoring the captive's formation (the "Sponsor"). This could be done by applying to the Sponsor the "Predominant Portion of Business Activities Test" described in the Majority FHLBank Position, starting on page A-6 of Exhibit A attached. The Sponsor would be the parent/owner of the captive, or if the parent itself has no employees or physical location of its own, its parent (and so on, to the first entity in the chain that has its own employees/physical location).

Finally, we have one relatively minor comment on the Proposed Rule, with respect to the "duly organized" requirement (a section that the FHFA has not proposed to modify from its current form). The FHLBank Act provides that, to be eligible for membership, an applicant must be "duly organized under Tribal law, or under the laws of any State or of the United States." Section 1263.7 of the regulation provides that an institution "shall be deemed to be duly organized" if it is "*chartered* by a State or Federal agency" as a depository institution or insurance company, or "in the case of a CDFI applicant, is *incorporated* under State or Tribal law." By using the words "chartered" and "incorporated," the regulation unnecessarily suggests a narrower approach than permitted by the statutory language, especially since modern state law provides multiple ways of organizing business entities, such as through the use of limited liability companies (LLCs) and other organizational structures. Because we do not believe that the FHLBank Act (or the FHFA) intended to restrict members from using any form of organizational structure that is permitted under the laws of their jurisdiction of organization, we suggest that Section 1263.7 be modified to read as follows:

> "An applicant shall be deemed to be duly organized, as required by section 4(a)(1)(A) of the Bank Act (12 U.S.C. 1424(a)(1)(A)) and § 1263.6(a)(1), if it is organized pursuant to the requirements of any applicable State, Federal or Tribal law, and is licensed, certified, or otherwise authorized by State, Federal or Tribal law to engage in the business of a building and loan association, savings and loan association, cooperative bank, homestead association, insurance company, savings bank, insured depository institution or CDFI."

In conclusion, we urge that the Proposed Rule be withdrawn, because we believe that the proposed changes to membership eligibility requirements would, if implemented, have an adverse effect on the FHLBanks, the housing finance market, and the communities served by our member financial institutions. We recommend that our comments with respect to principal place of business for insurance company applicants, and with respect to the "duly organized" membership requirement, be reproposed as part of a narrower effort to modernize the FHFA's membership regulation.

Thank you once again for the opportunity to comment on the matters raised in the Proposed Rule. Please feel free to contact me or the Bank's General Counsel, Carol Pratt, should you wish to discuss this submission in greater detail.

Very truly yours,

Edward A. Hjerpe III
President & Chief Executive Officer

Exhibit A

Comments on Principal Place of Business

The comments below reflect the views of the Federal Home Loan Bank of Boston with respect to the proposed principal place of business ("PPOB") provisions of the Federal Housing Finance Agency's ("FHFA's" or the "Agency's") notice of proposed rulemaking ("NPRM") regarding Federal Home Loan Bank ("FHLBank") membership, published on September 12, 2014. 79 Fed. Reg. 54848 (Sept. 12, 2014). The NPRM proposes, *inter alia*, to create an entirely new membership location rule for insurance company applicants by revising the regulation's treatment of an applicant's principal place of business ("PPOB"). [1]

The Federal Home Loan Bank Act ("FHLBA"), 12 U.S.C. § 1424(b) (2012), states that the location of a member's PPOB determines the FHLBank in which it may be a member. Since 1987, the term "principal place of business" had been defined in the membership regulation as the state where an institution "maintains its home office established as such in conformity with the laws under which the institution is organized." 12 C.F.R. § 1263.18(b) (the "home office test").

In 2012, the FHFA issued a regulatory interpretation indicating that sole reliance on an insurance company member's or applicant's state of domicile was insufficient when determining the appropriate district according to its "principal place of business." FHFA 2012-RI-02, 1 (Apr. 3, 2012) ("2012-RI"). However, the 2012-RI did not provide the FHLBanks with a clear alternative test for determining an insurance company's PPOB. The tests proposed in the NPRM are an improvement on the 2012-RI and we believe that, if amended as proposed herein, would provide a clear, simple, and easily applied PPOB rule.

Under the NPRM, an insurance company would be subject to one of three PPOB tests. Insurance company applicants would first be subject to the revised "general requirements" for establishing PPOB (the "revised home office test"). The applicant's district would be determined by "the state in which the institution maintains its home office established as such in conformity with the laws under which the institution is organized *and from which the institution conducts business operations.*" NPRM at 54865 (emphasis added)[2]

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[1] The NPRM notes that the amendments to the principal place of business regulation would apply prospectively and thus would not affect any existing FHLBank members. NPRM at 54865.

[2] *See id.* At 54865 ("Accordingly, the Banks would use [the proposed alternative test] only if an institution does not have an actual 'home office' established under the laws of its chartering statute, or it has such a 'home office' but does not conduct business operations from that location, or it cannot satisfy the three-part test of proposed §1263.19(c) for designating its principal place of business.") The 3-part test at 1263.19 (c) requires that all of the following criteria are met:

(i) At least 80 percent of the institution's accounting books, records, and ledgers are maintained, located, or held in such designated state;

(ii) A majority of meetings of the institution's board of directors and constituent committees are conducted in such designated state; and

(iii) A majority of the institution's five highest paid officers has its place of employment located in such designated state.

Second, if an insurance company applicant does not have an actual "home office" established under the laws of its chartering statute, or it has such a ''home office'' but does not conduct business operations from that location, or it cannot satisfy the three-part test of 12 C.F.R. § 1263.19(c), the NPRM, if adopted, would require that it "designate as the principal place of business the geographic location from which the entity *actually conducts the predominant portion of its business activities.*" *Id.* (emphasis added) (the proposed "alternative test"). In doing so, the FHLBank must assess the totality of the circumstances and objective factors, including: (1) the location from which the institution's senior officers direct, control, and coordinate its activities or (2) the locations from which the institution conducts its business. *Id.*

Third, for an insurance company applicant that maintain no physical offices of its own and has no employees of its own, or whose senior officers are located at multiple locations in different states, the NPRM proposes to designate the insurance company's state of domicile as its PPOB.

The FHFA states generally that the basis for the NPRM's approach to the PPOB tests is to ensure that an institution does not have its PPOB for FHLBA purposes at a particular location where it does not actually conduct at least some business operations. NPRM at 54865. The FHFA has taken the position that the interpretation set forth in the NPRM is supported by the reasoning set out in the Supreme Court's interpretation of "principal place of business" for diversity jurisdiction in *Hertz Corp. v. Friend.*[3]

We submit that a gap remains between the rules proposed in the NPRM and the three key elements needed in a membership location rule for insurance company members of the FHLBanks. These key elements are: (1) the centrality of an insurance company's state of domicile, (2) safety and soundness principles that call for effective relationships between FHLBanks and state Departments of Insurance, and (3) the need for the rule to be clear, simple, and predictable. If a change to the "home office test" is to be made, we submit that any new test should be defined and structured to provide the FHLBanks (which will ultimately apply the test) with sufficient guidance to effectively and efficiently determine the PPOB of insurance company applicants, with minimal likelihood of disagreement. Our proposed revisions would allow the NPRM's insurance company PPOB rule to address these core issues while still meeting the goals that the Agency has sought to achieve through its rulemaking proceeding.

Centrality of an Insurance Company's State of Domicile

An insurance company's state of domicile is the state in which an insurance company is licensed to do business and operates under the state's insurance statutes as a "domestic" insurer, where it is subject to the regulation and supervision of its primary regulator. Moreover, numerous state Departments of Insurance recognize an office or a registered office of each of its domiciled insurance companies in its examination reports and statutory statement filing requirements as the "statutory home office" for the domiciled company. The domiciled company's articles of

[3] 130 S. Ct. 1181 (2010). "FHFA believes that it should construe the Bank Act's reference to a member's 'principal place of business' in a similar manner to the way that the Supreme Court has construed that term." NPRM at 54866.

incorporation generally identify the address of this office but do not require that it be called a home office.

As the FHLBanks have previously noted in discussions and correspondence with the FHFA's Office of General Counsel, an insurance company's state of domicile is central to the regulation, examination, insolvency regime, and creditors' rights with respect to the insurance company. There is a substantial interrelationship between an insurer's insurance business and its pervasive and ongoing regulatory reporting obligations to its domiciliary Department of Insurance. Without such regular financial reporting and oversight, an insurer could not continue to operate its insurance business. An insurer's policies and other insurance product forms are required to be filed with and approved by the domiciliary state Department of Insurance prior to being issued. This domiciliary state review and approval is critical.

Additionally, in crafting a regulatory approach to the "principal place of business" of an insurance company, the FHFA should consider the highly regulated nature of insurance companies and the recognition of the primacy of state law in the regulation of the business of insurance starting with the state regulator's designation of "domicile" or "home office". By federal law, under the McCarran-Ferguson Act, 15 U.S.C. § 1011 *et seq.*, regulation of insurance is left to the states. *See U.S. v. Fabe*, 508 U.S. 491 (1993) (noting that "Congress left the regulation of insurance to the states."). The FHFA should give deference to state actions such as a state Department of Insurance's recognition of a statutory home office for each of its domiciled companies, and the proposed PPOB rules should be revised to better reflect the importance of an insurance company's state of domicile.

Safety and Soundness Principles Call for the Use of State of Domicile as the Primary Determining Factor in the PPOB Analysis

The principles of safety and soundness highlight the importance of a connection between applicants/members and their FHLBank district. As part of safe and sound operations, the FHLBanks must be "thoroughly familiar with the state insurance laws and regulatory framework for each state in which it has an insurance company member domiciled." (FHFA Advisory Bulletin, AB 2013-09).

A membership location test that embraces the importance of an insurance company's state of domicile would also minimize the number of FHLBank relationships that an individual state Department of Insurance will have to maintain. Each FHLBank has its own capital stock, lending, and collateral requirements. Primary use of the state of domicile limits the number of different FHLBank relationships in which an individual Department of Insurance must engage.

We are concerned that the insurance company PPOB test, as proposed in the NPRM, could result in added confusion and complexity in the relationships between FHLBanks and state Departments of Insurance. This would put a burden on these departments and on the FHLBanks, which would need to work through the possible definitions, interpretations, and iterations of the proposed rule.

Importance of a Clear, Simple, and Predictable Membership Location Test

The legislative history of the FHLBA indicates a preference for a simple, clear, and predictable rule regarding the districts of members. See *Hearings Before a Subcommittee of the Committee on Banking and Currency on S.2959*, 72nd Cong. 116–17, 359–60 (1932). During the hearings, a change was proposed to Section 4(b) of the FHLBA and ultimately incorporated into the final legislation, to allow adjoining district membership only "if demanded by convenience and then only with the consent and approval of the [B]oard," as opposed to an automatic rule. *See id.* at 199. Additionally, the drafters of the FHLBA took the nationwide scope of the insurance business into account. The discussion indicates the need to set a single state from which insurance company members would operate within the FHLBank System. *See id.*

Moreover, although not directly applicable, the fundamental principles discussed in the Supreme Court case cited in the NPRM, *Hertz Corp. v. Friend*, would be helpful in creating a rule to determine to which FHLBank an applicant should belong. These principles of clarity, simplicity and predictability, are essential to the FHLBanks' membership rules. A fundamental goal of the Supreme Court in *Hertz* was to unify disparate interpretations of "principal place of business" as it related to diversity jurisdiction, so as to provide a "single direction" for the courts applying the rule. The Court recognized the "need for certainty and predictability of result" as important to any jurisdictional test and knew that a simple rule would help ensure such certainty.

The NPRM, and previously the 2012-RI, does not achieve the clear, simple, and predictable rules that are necessary for effective and efficient membership location tests. The FHFA's proposed rule would require FHLBanks to analyze an insurance company applicant's business structure without clearly defining specific elements to consider to determine where the applicant conducts a "predominant portion of its business." This is a substantial change from the test that the FHLBanks were required to use under the "home office test,"[4] and such a qualitative, ambiguous rule could result in more than one FHLBank determining that an insurance company's PPOB is located in its district. Our propose revisions to the FHFA's proposed rule better reflect the principles of simplicity, clarity, and predictability.

FHLBanks' Proposed Enhancements to the NPRM's PPOB Tests

We propose the revisions below to bridge the gap between necessary key elements of a membership location rule for the FHLBanks and the goals that the FHFA seeks to achieve in amending the membership regulations. The proposed enhancements to the insurance company PPOB rule embrace the importance of an insurance company's state of domicile, bolster the FHLBanks' safety and soundness, and would improve the clarity, simplicity, and predictability of the rule, while recognizing and addressing the concerns of the Agency.

[4] Here, we refer to the "home office test" as analyzed prior to the 2012-RI which focused on the state of domicile. As the FHLBanks discussed with the Agency before this rulemaking proceeding, the 2012-RI was unclear and overly burdensome on the FHLBanks and applicants, and contravened guiding principles found in the legislative history of the FHLBA and the *Hertz* case.

The NPRM raises as a rationale for amending the current regulations a belief that the current membership location tests would allow an insurance company applicant to qualify for membership in an FHLBank based on a legal presence, but no other physical presence, in that FHLBank's district. In light of the way some insurance companies are structured, however, with both executives and operations potentially located in multiple FHLBank districts, the rule proposed in the NPRM is not a good fit for addressing this concern in a clear and workable fashion.

We propose the following revisions to the PPOB rule contained in the NPRM. These proposals seek to expand upon the foundational rule proposed by the FHFA and address the key elements discussed above. These proposed amendments are also drafted with an understanding of the structures utilized by many insurance company members and applicants.

The "Default" Rule (Test 1 in the Attached Chart):

Under the NPRM, the "default rule" for PPOB for an insurance company applicant is the company's home office established as such in conformity with the laws under which the institution is organized *and from which the institution conducts business operations.* [5]

We recommend that the FHFA modify its proposed rule revising the home office test to define "conducts business operations" specifically to include any of the following:

(i) the company has a business, operations, or sales office in the domiciliary state;

(ii) any company officer has his/her place of employment by the company in the domiciliary state; or

(iii) the company conducts any business in the domiciliary state, including selling policies or providing financial services from the state or in the state.

The addition of these specific definitions to the general "conducts business operations" term employed by the NPRM would provide the FHLBanks with much needed guidance regarding the application of the proposed "conducts business operations" provision of the PPOB rule. Further, the definition would allow applicants to easily determine the appropriate FHLBank to submit an application, thus, reducing the administrative burden on the FHLBanks and applicants alike. Reducing costs and roadblocks in the membership application process are essential to building and maintaining a robust membership.

Defining "conducts business operations" to include these factors also recognizes the concerns of the Agency, and would ensure that an applicant's PPOB is not a "mere legal" presence, but an indication of at least some business contacts with the state. The proposed revision tracks the goal of the NPRM, but includes specific metrics for applicants and the FHLBanks to employ when analyzing an applicant's PPOB. The added factors we propose would provide clarity and predictability to the "conducts business operations" aspect of the PPOB rule. Such uniformity

[5] *See* NPRM at 54879 (proposed 12 C.F.R. § 1263.19(b)).

would eliminate the possibility that two or more FHLBanks (or an FHLBank and an applicant) could disagree as to the application of the PPOB rule in specific contexts. This again reduces uncertainty and potential future complications.

Alternative to the Default Rule - Company without Own Operations (Test 2 in the Attached Chart):

Under the NPRM, for an applicant that has no physical office or employees of its own, or that has senior officers in different states, the PPOB would be the applicant's state of domicile.[6] We support this proposal, which is consistent with previous interpretations the FHFA has made, as well as the key elements set out in this Exhibit A.

This test encompasses all three key elements highlighted by the FHLBank. Through this test, the NPRM proposes a clear, simple, and predicable solution that embraces the importance of an applicant's state of domicile. The FHLBank believes that Test 1 or Test 2 will cover a majority of insurance company applicant membership issues.

Predominant Portion of Business Activities Test for Insurance Companies (Test 3 in the Attached Chart):

Under the NPRM, the FHFA has proposed that if neither the NPRM's revised home office test nor its three-part designation test applies to a particular insurance company applicant, then PPOB will be determined by the FHLBank, applying an alternative "predominant portion of business activities" test.[7]

The NPRM, however, does not define what constitutes "a predominant portion" and only generally refers to limited examples of what "business activities" should be considered. The NPRM directs FHLBanks to look to "the geographic location from which the institution actually conducts the predominant portion of its business activities" without defining "predominant portion" or "business activities."[8] The proposed rule would require the FHLBanks to generally examine the "totality of the circumstances of the particular case." This forces the FHLBanks to engage in a general business analysis – a type of analysis that the Supreme Court has found is "unusually difficult to apply."[9] This creates complexities and ambiguities that the FHLBanks' proposed revisions seek to avoid.

We are concerned that the "predominant portion of business activities" test is too subjective. The FHLBank seeking to apply this alternative test may not be able to apply it consistently or uniformly, and the resulting confusion among the FHLBanks and applicants may have a chilling effect on applications for membership, engender potential disagreements among FHLBanks, and at the very least increase the burdens on applicants and FHLBanks alike.

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[6] *Id.* (proposed 12 C.F.R. § 1263.19(f)).
[7] *Id.* (proposed 12 C.F.R. § 1263.19(f)).
[8] NPRM at 54866
[9] *See Hertz*, 559 U.S. at 90.

In place of the FHFA's proposed alternative "predominant portion of business activities" test, the FHFA should instead adopt a separate three-factor designation test solely for insurance companies that is specific and objective. An insurance company applicant seeking to use this test would certify to the FHLBank in the district in which it is domiciled that it meets the criteria, and that FHLBank's board would then make the designation. The insurance company would have to meet two of the following three tests:

(i) A plurality of the employees of the company have their primary place of employment in the FHLBank's district.

(ii) A plurality of the company's senior officers with titles that include "Chief," "President," "Executive Vice President," "Senior Vice President," or "General Counsel" have their primary place of employment in the FHLBank's district. Officer titles below the level of "Senior Vice President" or "General Counsel" are not included in determining whether this factor is met.

(iii) The location of the largest office (measured by number of employees of the applicant who work in such office) is in the FHLBank's district.[10]

If the board of the FHLBank in the district in which the insurance company applicant is domiciled fails to make the requested designation, the applicant would have the right to request that the FHFA make such designation, based on the applicant's certification with respect to at least two of these three tests.

In proposing this standard, we seek to respond to the concerns raised by the Agency in the NPRM. The NPRM stresses that a "mere legal presence" is not "sufficient to constitute a company's principal place of business for Bank membership purposes." NPRM at 54865. However, in seeking to ensure that more than a "mere legal presence" is met, the NPRM would create complexity and ambiguity.

The proposed rule would require the FHLBanks and applicants to each define what constitutes "business activities" and what volume of these activities constitute a "predominant portion." We propose to amend the NPRM by replacing the term "predominant portion of business activities" with a clear, black letter three-factor test that requires no additional interpretation. The three factors would provide clear and discernable metrics with which to assess the applicant's designated PPOB. Additionally, we propose that for insurance company applicants, this test would also replace the current three-factor designation test at 12 C.F.R. 1263.19(c). We believe that this proposed test better aligns with the nature and structure of insurance company operations than the existing three-factor test.

This proposal remains consistent with the current regulation's member-focused approach, reducing the burden on both the FHLBanks and applicants that the currently-proposed alternative

[10] If an applicant meets factor (ii), then the applicant's state for FHLBank director voting purposes would be the state in which it has the greatest number of senior officers. If the applicant does not meet factor (ii), then its voting state would be the state in which it has the largest office under factor (iii).

test would create. Similar to the current designation test, each insurance company applicant would work with the FHLBank in designating the correct PPOB for its individual business structure. The revisions proposed above thus remove uncertainty and complication from the membership location analysis.

These Revisions Proposed Above Unite the NPRM's Goals with the Three Key Elements of a Membership Location Rule for Insurance Companies

Taken as a whole, the three tests proposed by the FHFA, modified as described above, would fulfill the goal of a clear, simple, and predictable test for membership location for insurance company applicants while addressing the FHFA's stated concerns. We believe that the proposed amendments are needed to make the NPRM's insurance company PPOB rule more workable.

As discussed above, an insurance company's state of domicile is an important location for the regulation and governance of the company—moreover, the use of the state of domicile follows from the fundamental questions of safety and soundness. Accordingly, the insurance company PPOB final rule should be drafted so as to embrace the state of domicile as an insurance company applicant's "home office" whenever possible in accordance with the FHFA's other concerns. Further, although not directly applicable, the underlying rationale of *Hertz*, as well as the legislative history of the FHLBA, guides the FHFA towards a clear, simple, and predictable test for determining the appropriate district for an applicant to an FHLBank. The NPRM's PPOB rule, as drafted, falls short of this goal, but provides a solid foundation upon which we recommend these revisions to help the proposed rule, if finalized, meet all the requirements of an effective and practical membership location test.

CONCLUSION

The FHLBank System benefits from clear and easy-to-apply membership rules. An insurance company's state of domicile is its legal and regulatory center. The primary membership location criteria should provide an unambiguous test, while preserving the importance of an insurance company's state of domicile and addressing the concerns raised by the FHFA. The membership rules must provide a simple and predictable metric for determining which FHLBank district is appropriate for an applicant. The suggested revisions above will enable the proposed rule to fulfill this goal.

Under these proposed revisions, the revised home office test would embrace the central role of the state of domicile while alternative rules would ensure that an insurance company becomes a member in the appropriate district when it has no business ties to its state of domicile. The definition of "conducts business operations" proposed above will provide certainty to FHLBanks and applicants applying the regulation. An insurance company specific designation test will provide a simple and straightforward alternative to the general rule. For the reasons discussed above, we respectfully request that the FHFA adopt these proposed revisions to the membership rules contained in the NPRM.

Principal Place of Business (PPOB) Decision Chart

Insurance Companies

Test 1—Addition to Proposed 12 C.F.R. 1263.19(b)—Definition of "Conducts Business" for an Insurance Company:	**Test 2– Domicile Test Per Proposed 12 C.F.R. 1263.19(f)**	**Test 3 Replace Predominant Portion Test of Proposed 12 C.F.R. 1263.19(f) with an Alternative 3 Factor Test for Insurance Companies (Must Meet 2 of 3 Factors)**
The insurance company meets any one (1) of the following: 1. The company has a business, operations or sales office in the domiciliary state. 2. Any company officer has his/her place of employment by the company in the domiciliary state. 3. The company conducts business in the state of domicile defined to include "sells policies" (including, without limitation, reinsurance policies or contracts of reinsurance) or provides financial services from or in the state of domicile. Resulting PPOB for FHLBank membership: If one of the factors is met, state of domicile.	Resulting PPOB for FHLBank membership: state of domicile	Proposed alternative 3-factor test: The insurance company would have to meet 2 of the 3 factors below: 1. A plurality of the employees of the applicant company have their primary place of employment in the FHLBank's district. 2. A plurality of the applicant's senior officers with titles that include "Chief," "President," "Executive Vice President," "Senior Vice President" or "General Counsel" have their primary place of employment in the FHLBank's district. Officer titles below the level of "Senior Vice President" or "General Counsel" are not included in determining whether this factor is met. 3. The location of the largest office (measured by number of employees of the applicant who work in such office) is in the FHLBank's district. Resulting PPOB for FHLBank membership: district where the insurance company meets 2 of the 3 stated factors. Also, if the applicant meets factor 2, then the applicant's state for FHLBank director voting purposes is the state in which it has the greatest number of senior officers. If the applicant does not meet factor 2, then the voting state is the state in which it has the largest office as measured by the number of employees.