The Wisconsin Credit Union League
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Submitted electronically via *FHFA.gov* and via email to *RegComments@fhfa.gov*

Jan. 12, 2015
Alfred M. Pollard, General Counsel
Federal Housing Finance Agency
400 Seventh Street SW, Eighth Floor
Washington, D.C. 20024

Re: Notice of Proposed Rulemaking; Request for Comments – Members of the Federal Home Loan Banks
RIN 2590-AA39

Dear Mr. Pollard:

On behalf of Wisconsin's credit unions® and their 2.5 million members, the Wisconsin Credit Union League welcomes the opportunity to comment on the Federal Housing Finance Agency's (FHFA) proposal to revise the eligibility requirements for credit unions and other institutions to join and maintain memberships in Federal Home Loan Banks (FHLBs).

We respectfully ask the FHFA to withdraw this proposal, which would:

- Conflict with NCUA regulations on liquidity, concentration risk and interest rate risk;
- Contradict Congress' intent;
- Unfairly discriminate against credit unions and in favor of banks;
- Threaten the ability of credit unions to compete effectively with much larger financial institutions and to offer their home-buying and business borrowers more choices and better service;
- Limit credit unions' access to the secondary market; and
- Undermine the FHLB system, eroding confidence in the FHLBs as sources of stable and reliable liquidity.

Background

Currently, 34 Wisconsin credit unions are members of the FHLB of Chicago. They value the importance of FHLB membership. Access to the FHLB advances provides the needed liquidity that allows them to offer members an array of loan products. FHLB products – such as advances, letters of credit and the Mortgage Partnership Finance® (MPF) Program – help Wisconsin credit unions compete effectively with much larger financial institutions, giving their home-buying and business borrowers more choices and better service.

Wisconsin credit unions want to remain FHLB members, but the proposal would impose onerous new restrictions that would threaten continuing membership eligibility:

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Member Credit Union National Association

- 10% Test: All credit unions, as well as banks with assets above $1 billion in assets, would need to keep at least 10% of assets in "residential mortgage loans" (a term that comprises most real estate loans of any duration, including junior loans, loans for manufactured housing, and construction loans). By statute, *banks* (but not credit unions) with assets below $1 billion are considered "Community Financial Institutions" (CFIs) and are exempt from this requirement.

- 1% Test: In addition to satisfying the 10% test, all FHLB members (including CFIs) would need to have 1% of assets in "home mortgage loans" ( long-duration (five years or longer), first-lien, single and multi-family mortgages, mortgage backed securities, or collateralized mortgage obligations). The proposal contemplates that this requirement could be as much as 5%.

Failure to meet either proposed test for two consecutive years would result in the termination of a credit union's FHLB membership.

The Wisconsin Credit Union League has a variety of concerns with this proposal, which would have potentially severe consequences and should be withdrawn.

<u>The proposal conflicts with NCUA regulations</u>

This proposal is fundamentally at odds with various regulations from the NCUA and other agencies.

*Liquidity rules:* Since the financial crisis, credit unions' prudential regulator, the National Credit Union Administration (NCUA), has emphasized the importance of access to reliable liquidity sources in an effort to strengthen the credit union system. *See* NCUA Regulations §741.12, "Liquidity and Contingency Funding Plans," and NCUA Letter to Credit Unions 13-CU-10 (October 2013). The availability of same-day funding offered by the FHLBs can play a critical role in supporting and stabilizing credit unions during times of economic stress. Yet this proposal contradicts the NCUA's efforts to strengthen the credit union system by undermining the reliance of member credit unions on the FHLBs. This threatens to weaken the broader financial system while doing nothing to help prevent a repeat of the financial crisis.

*Concentration risk rules:* NCUA's proposed risk-based capital rule (79 Fed. Reg. 11184, Feb. 27, 2014, RIN: 3133-AD77) and the Basel III-based capital rules for banks both *limit* concentration in specific asset classes. What, then, can justify the FHFA's proposal to *require* concentration in residential mortgages? The net effect of these two rules together would be an exceptionally high level of capital for credit unions – too high for some to be competitive in the marketplace.

The proposal would artificially distort balance sheet management practices, decreasing the credit unions' flexibility to manage their assets and liabilities in response to changing market conditions. And they would have to maintain those distorted concentrations from year to year, to ensure continuing eligibility for FHLB membership. Furthermore, given that housing losses led to the last financial crisis, requiring heavy concentrations in mortgage lending would jeopardize the safety and soundness of U.S. financial institutions in general.

*Interest rate risk rules:* Under the proposal, credit unions could become over-invested in housing-related assets at the expense of consumer loans, business loans or other asset classes. This might also unduly expose them to the interest rate risk associated with holding long-term, fixed-rate mortgage loans, counter to NCUA requirements for sound interest rate risk management programs. *See* NCUA Regulations §741.3 (b)(5) and Appendix B to Part 741, "Guidance for an Interest Rate Risk Policy and an Effective Program."

The proposal contradicts Congress' intent

Congress has explicitly recognized the FHLBs' mission of providing liquidity to members – *without* limiting that purpose to housing finance. By seeking to establish a housing finance nexus that all FHLB members must meet, the proposal does not appear to recognize the legitimate uses of FHLB funding beyond housing finance activities.

Congress has steadily expanded, never contracted, membership requirements throughout the 82-year history of the FHLBs. The FHFA has failed to make a persuasive case that such a reversal of policy is necessary.

Congress, not the regulator, should define who can maintain membership in an FHLB. The FHFA is under no statutory obligation to impose these membership limits on an ongoing basis.

The proposal unfairly discriminates against credit unions

The proposal's disparate treatment between credit unions and banks is fundamentally unfair. The proposal would require all credit unions to maintain at least 10% of their total assets in residential mortgage loans, but only banks with assets above $1 billion would be subject to the same on-going requirement. Smaller banks, designated as CFIs, would not be subject to the 10% test. Clearly, requiring credit unions to continually satisfy this 10% requirement would be fundamentally unfair, and it would disadvantage smaller credit unions in particular.

If there is going to be a regulation, the FHFA should at least provide parity so that banks and credit unions are treated equally for purposes of maintaining membership. While the statute does not allow credit unions to be considered CFIs for purposes of securing FHLB membership, all credit unions should be treated as CFIs for purposes of maintaining FHLB membership and should not have to meet the 10% test on an ongoing basis. In the alternative, all credit unions below the same asset threshold as banks should be treated as CFIs for purposes of maintaining FHLB membership.

The proposal would harm credit unions & the U.S. financial system

The practical consequences of this proposal for Wisconsin credit unions would be severe and disruptive. FHLB membership is a critical tool of liquidity for many credit unions. Because credit unions have more limited sources of liquidity than large financial institutions have, their FHLB memberships are critical to help them compete effectively with much larger financial institutions – to the benefit of home buyers. This regulation could hamper growth of the credit union system by forcing some credit unions out of the FHLB membership.

Member credit unions' ability to rely on the liquidity provided by the FHLBs, particularly in times of economic distress, would be seriously undermined if the FHFA establishes ongoing membership tests. Particularly troubling, the credit unions would have no assurance of continued access to FHLB liquidity when the next financial crisis occurs. Thus, while the change would threaten a credit union's ability to rely on FHLB liquidity, it would do nothing to help strengthen the U.S. financial system – and could actually harm it.

The proposal would limit credit unions' access to secondary markets

Many institutions rely upon the FHLBs' MPF® Program to access the secondary mortgage market. This innovative program has been popular with FHLB members, particularly smaller mortgage lenders, because it allows them to access the secondary mortgage market on competitive terms while retaining member relationships. The traditional MPF products also pay participating FHLB members monthly fees to manage the credit risk of their own loans, in contrast to the guarantee fees charged by Fannie Mae and Freddie Mac. Rather than furthering this program, however, the proposal would only harm it by encouraging members to hold more mortgage loans on their balance sheets, rather than selling them.

The regulation restricts access to secondary markets for FHLB members that do not meet the arbitrary tests being proposed. This has broad implications outside of this proposal. For example, during the 2013-2014 debate over housing finance reform, expanding – not limiting – the FHLBs' ability to serve as a source of secondary market access for small financial institutions was an important part of the legislative proposals.

The proposal would undermine the FHLB system

We also are very concerned this proposal threatens to undermine the FHLB system in a variety of ways.

- It could lead to the politicization of FHLB membership. If the FHFA can require ongoing eligibility requirements for members, nothing would prevent it from increasing those thresholds, or imposing entirely new requirements, in the future. This proposal might simply be the first of many such eligibility requirements imposed upon FHLB members, purportedly in an effort to ensure a sufficient housing finance nexus is maintained at all times by members. The FHFA director is a political position, appointed by the President and confirmed by the U.S. Senate. What would prevent a future FHFA director from requiring FHLB members to hold yet more housing loans or other types of assets on their balance sheets in order to achieve a certain political agenda? Such fears are not unfounded. Past Administrations from both political parties increased housing goals for Fannie Mae and Freddie Mac in an effort to increase the level of homeownership and serve politically favored constituencies, with disastrous results.

- A similar concern exists as to the ability to terminate the memberships of current FHLB members without any showing of cause. Under the proposal, the current memberships of captive insurance companies would be terminated regardless of the amount of home mortgage loans they hold on their balance sheets. This would occur despite the fact that captives are insurance companies, which have been eligible to be FHLB members since the FHLBs were created by Congress in 1932. If the FHFA can terminate the memberships of a certain class of insurance companies, it raises a legitimate concern as to what, if anything, would prevent the FHFA in the future from terminating the memberships of other types of current members for any reason the FHFA sees fit. Such an outcome would destroy any confidence in the FHLBs as sources of stable and reliable liquidity. The FHFA will open a Pandora's Box if it approves the rule as proposed.

- The overall intent of this proposal seems to restrict and narrow FHLB membership, resulting in fewer members. As some members have their memberships terminated, and others are forced to reduce their usage of the FHLBs, we are concerned about the destabilizing effects that would result. These actions will inevitably lead to smaller FHLBs with fewer assets, reduced profits, lower retained earnings, and a decreased market value of equity and capital stock. Additionally, as usage contracts and profits decline, fewer dollars will be available to support the FHLBs' affordable housing and economic development programs. The ability of Wisconsin credit unions to serve their members and communities through valuable products such the FHLB's down payment assistance grants, Community Investment Cash Advances and Affordable Housing Program grants would be harmed.

Conclusion

The FHLBs are valuable partners for Wisconsin credit unions. Their reliability as a liquidity source must be preserved. Threatening access to the FHLBs threatens our credit unions, their members and their communities.

This proposal is fundamentally at odds with NCUA regulations on liquidity, concentration risk and interest rate risk, and it contradicts Congressional intent. It would unfairly discriminate against credit unions and in favor of banks, while at the same time threatening the ability of credit unions compete effectively with much larger financial institutions and to offer their home-buying and business borrowers more choices and better service. The proposal would limit credit unions' access to the secondary market. Ultimately, it would undermine the FHLB system, eroding confidence in the FHLBs as sources of stable and reliable liquidity.

Despite these real and damaging effects, it appears that this proposal would achieve no specific benefits. The costs clearly outweigh the benefits. For these reasons, we strongly urge that the proposal be withdrawn.

Thank you.

Sincerely,

Paul Guttormsson
Regulatory Counsel & Director of Compliance Services
The Wisconsin Credit Union League