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Alfred M. Pollard, General Counsel
Attn: Comments / RIN 2590-AA39
Federal Housing Finance Agency
400 Seventh Street SW, 8th Floor
Washington, DC 20024

Re: Notice of Proposed Rulemaking RIN 2590-AA39

Dear Mr. Pollard:

The Federal Housing Finance Agency ("FHFA") proposes to revise its regulations regarding membership in the Federal Home Loan Banks (individually, an "FHLBank," and, collectively, the "FHLBanks"), pursuant to the Notice of Proposed Rulemaking referenced above (the "Proposed Rule"). Our firm represents the Federal Home Loan Bank of Indianapolis ("FHLBI"). A partner of our firm assisted in the formation of FHLBI in 1932 pursuant to the Federal Home Loan Bank Act of 1932 (as amended, the "Bank Act"), and we have served as primary outside counsel to FHLBI throughout almost all of its eighty-two year history. Consequently, we have worked with FHLBI throughout various changes to the Bank Act as enacted by Congress, including the Financial Institutions Reform, Recovery, and Enforcement Act of 1989, the Gramm-Leach-Bliley Act of 1999, and the Housing and Economic Recovery Act of 2008. Additionally, our firm is counsel to a number of institutions that are members of FHLBI or another FHLBank. This comment letter, however, is being provided in our own capacity, and not as a representative of the FHLBI or any other institution.

The Proposed Rule will reduce the stability and reliability of the FHLBank system.

One of the hallmarks of the FHLBank system is its long-standing stability and reliability. This stability is important for the FHLBanks, for their respective members/owners, and for the institutions that purchase the Consolidated Obligations that provide the financing needed for FHLBanks to make advances to members. While benefitting from this reliability and stability, the members of the FHLBanks have had the flexibility to manage their own balance sheets and take appropriate action to smooth out their overall interest rate risk profiles.

Stability is essential for the members of the FHLBanks for several reasons. In making a decision to join an FHLBank, a current or prospective member must have some certainty as to the rules of entry and an understanding that there will not be ongoing and changing compliance

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criteria. Members must have the ability to adapt to changing market conditions and adjust their activities and balance sheets accordingly, while working with their respective primary regulators to ensure safety and soundness in their activities. Thus, introducing ongoing requirements that member institutions must hold at least 1% of assets in home mortgage loans, and non-CFI depositories must hold at least 10% of assets in residential mortgage loans, will limit the flexibility of those members to operate their businesses in a financially advantageous manner. Additionally, members make their investment in the FHLBanks to give them assurance that necessary advances will be available to support their housing-related activities, even during periods of financial crisis, such as the recent Great Recession.

Members, non-profit organizations and communities also rely on the stability of the FHLBank Affordable Housing Program ("AHP"). The funds available for grants and below-market interest loans through the AHP are particularly important for the FHLBanks to support housing initiatives and economic development in disadvantaged communities throughout the United States, especially in times of financial downturn. FHLBI members use AHP funds to serve the needs of seniors, the disabled, homeless families, first-time home buyers and others with limited resources in Indiana and Michigan. By restricting membership in the FHLBanks, the Proposed Rule could reduce FHLBI's net income, thereby decreasing AHP funds that are badly needed to benefit underserved populations.

The Proposed Rule could have a detrimental impact on the purchase of Consolidated Obligations.

Since 2005, the FHLBanks have been required to register their securities under the Securities Exchange Act of 1934, as amended. Although the registration pertains to the equity securities of each FHLBank, which are not publicly traded, the detailed descriptions and discussion of each FHLBank and its financial statements are of paramount interest to purchasers and holders of the Consolidated Obligations issued through the Office of Finance. Consolidated Obligations, which are the joint and several obligations of the twelve FHLBanks, provide the funds through which each FHLBank makes loans in the form of advances to its members and provides liquidity for the housing market. Purchasers of Consolidated Obligations have relied on the stability and reliability of the Federal Home Loan Bank system for decades. We believe that FHFA should consider the potential detrimental impact on the purchase of Consolidated Obligations if the Proposed Rule were to be adopted. Surely FHFA does not intend to rattle the marketplace, but implementing a rule that reduces FHLBank membership, profits, and stability could very likely lead to hesitation and reluctance on the part of Consolidated Obligation purchasers, which will lead to higher rates on, and less borrowing through, advances, thereby further dampening FHLBank income.

The proposed change to the principal place of business ("PPB") determination for insurance companies will decrease the benefits of the FHLBank regional system.

When Congress established the FHLBanks, it divided them into a regional system allowing for each FHLBank to develop an approach that best suits the particular character and types of institutions that are, or may become, their respective members. In the case of FHLBI, its district consists of the states of Indiana and Michigan, which are attractive domiciles for insurance companies. Michigan is especially attractive to captive insurers because, unlike many other states, Michigan has well-developed captive insurance laws. Consequently, FHLBI has enjoyed steady growth among its insurance company membership.

With such a strong presence of insurers among its members, FHLBI has forged strong working relationship with the insurance regulators of Indiana and Michigan, and we assume that the other FHLBanks enjoy good relationships with the regulators of the states in their districts as well. FHLBI also benefits from Michigan's and Indiana's insurance laws that clearly protect secured creditors, including FHBLI. The real-life benefits of favorable laws and strong relationships were made evident when the Standard Life Insurance Company of Indiana failed. As described in Paul Borja's comment letter, the Indiana insurance regulator fully understood that FHLBI was "a secured creditor and liquidity provider," and "FHLBI was able to work with the rehabilitator to accomplish a successful workout where neither FHLBI nor any insurance policy holder took a loss."[1]

Under the Bank Act, the FHLBank district that a member can join is based on its PPB, which is principally determined by state of incorporation, domicile, or charter. Current regulations provide that PPB is the state in which a member "maintains its home office established as such in conformity with the laws under which the institution is organized."[2] An alternative test allows for an institution to designate its PPB in a state other than its domicile if the following three factors are present and the FHLBank district is willing to accept institution: (i) at least 80% of the institution's accounting books, records and ledgers are maintained in that state; (ii) a majority of the institution's board of directors and board committee meetings are held in that state; and (iii) a majority of the institution's five highest paid officers have their places of employment in that state.[3] Nonetheless, the primary determination of PPB is state of domicile or charter.

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[1] *See* Paul D. Borja comment letter dated December 3, 2014 p. 1.

[2] 12 C.F.R. § 1263.18(b).

[3] 12 C.F.R. § 1263.18(c)(1).

Insurance companies, like depository institutions, are subject to the laws of all places where they do business, but if a failure occurs, the laws and regulations of the domicile state matter the most. This is true because the ultimate authority on security interests in any entity's assets is the law of the state of domicile, and the company's primary insurance regulator will oversee the liquidation process. As established in the Standard Life case, regional relationships and understanding of applicable law create a great advantage in protecting FHLBank interests, which strengthens the stability of the FHLBank system and its ability to issue and repay Consolidated Obligations and to provide liquidity to our nation's housing market. This benefit could be lost if the primary PPB determination for an insurance company is changed in any way from the location of its primary regulator and the laws that govern security interests in its assets.

Additionally, captive insurers should not be distinguished from other insurance companies for purposes of PPB determination. If such a distinction were made solely to leverage the historical siting of large financial institutions' headquarters in very large metropolitan areas, one would have to assume that the laws and regulatory oversight of the captive insurer's domicile are somehow less relevant than for other insurers. Specifically, creating a distinction between captive insurers and other insurers for PPB purposes would ignore three universal features of FHLBank advances: (i) the FHLBank's secured creditor relationship with any insurance company member would still be governed by the laws of the insurer's domicile; (ii) the member's state regulatory requirements would still be imposed and overseen by the captive's domicile state; and (iii) an FHLBank's decision to lend to a captive insurer—and every other insurer—would be inextricably tied to the financial stability of the member institution and the quality of the collateral, not the organizational structure—or location—of the member's affiliates. Furthermore, there is no meaningful safety/soundness rationale for creating different PPB rules for captive insurers.

FHFA's proposed new definition of "insurance company" excludes eligible captive insurers from FHLBank membership and is an unauthorized amendment to the Bank Act.

The Proposed Rule's amended definition of an "insurance company" would have a negative impact on FHLBI's membership, is clearly beyond FHFA's statutory authority, and is contradictory to Congressional intent and a plain reading of the Bank Act. Moreover, this amended definition, when coupled with other parts of the Proposed Rule and other recent rulemakings by the various federal agencies with respect to Qualified Mortgages ("QMs") and Qualified Residential Mortgages ("QRMs"), provides further pressure on much needed liquidity in the housing market at a time that historic funding mechanisms such as the Government Sponsored Enterprises ("GSEs") face an uncertain future.

The Proposed Rule would limit the types of insurance companies that are eligible for 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 definition of "insurance company" will exclude from Bank membership captive insurers, but permit existing captive members to remain members for five years with certain restrictions on their ability to obtain advances.

FHFA is attempting to rely on its ability to define ambiguous terms in the law, but no example is given to show that there could be conflicting interpretations of the meaning of the term "insurance company." A careful review of the eligibility for membership provisions pursuant to 12 U.S.C. § 1424(a)(1) reveals what can only be assumed to be Congressional deference to state law. Specifically, this enabling language provides in part,

> *Criteria for eligibility. In general. Any building and loan association, savings and loan association, cooperative bank, homestead association, insurance company, savings bank, community development financial institution, or any insured depository institution (as defined in section 1422 of this title), 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 or of the United States or, in the case of a community development financial institution, is certified as a community development financial institution under the Community Development Banking and Financial Institutions Act of 1994 [12 U.S.C.A. § 4701 et seq.]....*[4]

Because Congress only provided definitions of insured depository institutions and community development financial institutions in this section, it appears that Congress intended to defer to state law for the definitions of the remaining entities, which are predominantly state-chartered and/or incorporated.

In the preamble to the Proposed Rule, FHFA provides the following flawed reasoning to support banning captive insurance companies, "[w]hen Congress authorized insurance companies to become Bank members in 1932, the concept of captive insurers was essentially unknown in the United States. At that time, insurance companies, particularly life insurance companies, frequently made or purchased mortgage loans which, as longer-term investments,

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[4] 12 U.S.C. 1424(a)(1).

better matched the liabilities that the insurance companies had to their policyholders." First, as noted in Venable's comment letter, while the phrase "captive insurance" was not coined until 1958, the concept of captive insurance predates the Bank Act.[5] In fact, when the Church Insurance Company was formed in 1929, the news made the front page of the May 23, 1929 edition of the New York Times, and its first Board of Directors included such notable figures as J. Pierpont Morgan, Stephen Baker (Chairman of the Board of Bank of Manhattan Company), George W. Wickersham (former U.S. Attorney General), and Frank L. Polk (former U.S. Under Secretary of State).[6]

We further note the importance of maintaining the regulatory flexibility to adapt to the ever changing financial services market place. The insurance industry has undergone significant expansion and change over the last eighty years, during which time Congress, despite its ability to do so, has not amended the Bank Act to exclude captive insurers or any other specific insurance entity from the definition of "insurance company." If FHLBank members were limited only to engaging in those activities and offering those products available when the Bank Act was passed, we would either have a financial system unable to keep up with a complex global economy or we would have no FHLBanks.

Looking to the specific nature of captive insurers, it is noteworthy that, in some instances, insurance companies, and most recently many life insurance companies, form captive insurers as a manner by which to manage risk. In July, 2013, the National Association of Insurance Commissioners ("NAIC") released a whitepaper entitled, "Captives and Special Purpose Vehicles" in which the growth of captive insurers held by insurance holding companies and insurers within an insurance holding company was examined. Contrary to what many unfamiliar with the insurance industry may assume, state insurance regulators have developed an extensive and far-reaching oversight process that effectively and efficiently regulates all insurers, including captive insurance companies.

Simply stated, captive insurance companies are "insurance companies." They are organized under and subject to state laws and regulations. FHFA first introduced its concept of banning captive insurance companies from the FHLBanks in its December 27, 2010 Advance Notice of Proposed Rulemaking ("ANPR"). Despite FHFA's stated concern, Congress, as it has done for 82 years, chose not to amend the Bank Act to exclude captive insurers. It is beyond FHFA's authority to amend laws enacted by our elected Congress; consequently, the proposed captive insurer ban should be withdrawn.

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[5] *See* Venable comment letter dated October 8, 2014 pp. 16-19.

[6] John Scheffler, *Church Insurance*, (March 15, 2014) available at http://www.dioceserg.org/files/uploaded/files/Treasurers%20Work%20Shp%20-%20Dio%20of%20the%20Rio%20Grande.pdf

Policy considerations for allowing flexibility in membership.

In the wake of the Great Recession and the subsequent receivership of the GSEs, the private capital markets, including among them captive insurers and mortgage REITs, are starting to help fill a housing liquidity void and to fuel economic recovery. We feel compelled to reiterate the important point made by several other commenters to date that Congress has chosen to expand and continue to support enhanced membership parameters for the FHLBs, and we question the logic in attempting to contract FHLBank membership at any time, especially during a period of economic recovery.

As FHFA concedes, banning captive insurers from membership, does not eliminate an ineligible institution's ability to obtain FHLBank funds through traditional insurance companies and even depository institutions. Congress did not provide that a member, including an insurer, could only access FHLBank liquidity if it were affiliated with and supported only certain institutions. Instead, Congress saw the benefit of providing insurers and the other institutions identified by 12 U.S.C. § 1424(a)(1) the discretion to invest in mortgage loans. To restrict this ability is, as several other commentators have noted, clearly overstepping FHFA's authority and contrary to public policy.[7]

Market liquidity in the wake of implementation of the Qualified Mortgage and Qualified Residential Mortgage standards.

We further question the prudence of the Proposed Rule in light of market liquidity concerns associated with the recent implementation of amendments to Regulation Z by the Consumer Financial Protection Bureau ("CFPB") with respect to Qualified Mortgages ("QMs"), and the accompanying December 24, 2014 adoption of the final rule by the various federal regulatory agencies[8] to implement Section 941 of the Dodd-Frank Act with respect to credit risk retention for non-Qualified Residential Mortgages ("QRMs"). While the QRM rule has only just been adopted, the definition of a QRM is consistent with that of a QM.[9]

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[7] *See* FHLB Atlanta comment letter dated December 24, 2014, Dechert LLP comment letter dated October 31, 2014, Milton J. Miller, II, former President and CEO of FHLBI comment letter, October 6, 2014.

[8] On December 24, 2014 the OCC, the Board of Governors of the Federal Reserve System, the FDIC, SEC, FHFA and HUD issued their final Rule implementing the credit risk retention requirements of section 15G of the Securities Exchange Act of 1934, as added by Section 941 of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

[9] *See* 12 C.F.R. §1026.43(e)(2) and (4).

QMs are afforded a regulatory safe harbor from alleged violations of the ability to repay standards contained in Regulation Z.[10] Since adoption of the QM Rule by the CFPB in early 2014, liquidity in the non-QM market has been nascent, and, while the extent to which FHLBank members may engage in non-QM lending activities is unknown, we question the value of any policy that may further constrain liquidity, whether directly or indirectly, to creditors in this market.

There is no need to adjust the metrics used by the FHLBanks for determining the financial condition of insurance companies or any other members.

FHFA has requested "comments regarding the type of metrics or other criteria that would be appropriate indicators that an insurance company is in a financial condition such that advances may be safely made to it and how such metrics or benchmarks should reflect the business models and risks insured by different types of insurance companies." There is no need to deviate from current FHLBank underwriting principles. Currently, FHLBI members must satisfy their regulatory capital requirements and a sufficient FHLBI review. The FHLBanks have many years of underwriting experience and the ability to obtain what they need to adequately review a member's financial condition. In addition to FHLBI's review, insurance company members are subject to regulation and oversight by the Indiana and Michigan state insurance departments, whose trained and experienced representatives rigorously review and analyze their financial condition. There is no need to second-guess the regulators' analysis or to impinge on each FHLBank's autonomy by prescribing new metrics.

Given the issues and adverse consequences which result from the Proposed Rule, as identified herein and in other comment letters received by FHFA, we respectfully request that the Proposed Rule be withdrawn from further consideration.

KRIEG DeVAULT LLP

By:
William R. Neale, Partner

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[10] *See* 12 C.F.R. §1026.43(c).