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January 12, 2015

Mr. Alfred M. Pollard  
General Counsel  
Attention: Comments/RIN 2590-AA 39  
Federal Housing Finance Agency  
400 Seventh Street, S.W., Eighth Floor  
Washington, DC 20024

Re: Notice of Proposed Rulemaking; Request for Comment; Members of Federal Home Loan Banks; RIN 2590—AA39

Dear Mr. Pollard:

The Financial Services Roundtable (FSR) and its Housing Policy Council (HPC)<sup>1</sup> appreciate the opportunity to provide these comments on the Federal Housing Finance Agency's (FHFA) notice of proposed rulemaking (NPR) to revise the requirements for membership in an Federal Home Loan Bank (FHLB). The members of FSR and HPC include depository institutions and insurance companies that are members of one or more FHLBs. As a result, FSR and HPC have a direct interest in the subject matter of the NPR.

The NPR proposes to make several changes in the requirements for membership in a FHLB. Specifically, the NPR would (1) require that an institution must have at least one percent of its total assets in "home mortgage loans" on an ongoing basis; (2) expand the list of assets that qualify as "home mortgage loans" to include all types of mortgage-backed securities that are fully backed by residential mortgage loans or by other securities backed by such loans; (3) require that a member that is subject to the existing requirement that 10% of its total assets consist of "residential mortgage loans" meet that requirement on an ongoing basis; (4) define the term "insurance company" to exclude captive insurers from membership in an FHLB; (5) impose certain financial reporting requirements on insurance companies that are members of an FHLB and (6) define what constitutes a "principal place of business" for insurance companies that are members of an FHLB.

The FHFA has explained that the proposed quantitative standards are designed to ensure that the benefits of membership in an FHLB accrue only to institutions that

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<sup>1</sup> The Housing Policy Council of The Financial Services Roundtable consists of thirty-two of the leading national mortgage finance companies. HPC members originate, service, and insure mortgages. We estimate that HPC member companies originate approximately 75% and service two-thirds of mortgages in the United States. HPC's mission is to promote the mortgage and housing marketplace interests of member companies in legislative, regulatory, and judicial forums.



demonstrate a meaningful commitment to supporting residential housing finance. FHFA also has explained that the proposed prohibition for captive insurers is intended to prevent certain institutions, primarily real estate investment trusts, from using captive insurers to gain access to FHLB advances that they are not eligible for directly.

FSR and HPC strongly support the mission of the FHLBs. The FHLBs are an important source of liquidity, especially for residential housing finance. Thus, we appreciate the intent of the NPR. However, as discussed below we are concerned about the potential for a conflict between the proposed quantitative standard and other federal and state solvency requirements. Additionally, we do not believe that the proposed definition of the term “insurance companies” can withstand judicial review since it is inconsistent with common law interpretations of that term. Therefore, we urge FHFA to reconsider these two features of the NPR.

#### The Proposed Quantitative Standards Conflict with Other Regulatory Standards and Constrain Balance Sheet Management

The proposed quantitative standards for membership conflict with other regulatory standards, and, as a result, could unintentionally jeopardize membership in an FHLB for an institution. One such conflict exists between the NPR and the liquidity coverage ratio (LCR) regulation that was issued recently by the federal banking agencies.<sup>2</sup> The LCR regulation requires large banking organizations to hold high-quality liquidity assets in order to meet cash needs for a 30-day period during stressed economic conditions. That regulation defines a high-quality asset to include U.S. Treasury bonds and debt instruments issued by European Union countries. Residential mortgages and mortgage-backed securities (other than those guaranteed by a government-sponsored enterprise) are not classified as high-quality assets under the regulation. Thus, the LCR rule discourages large banking organizations from holding residential mortgages and mortgage-backed securities at the same time as the NPR would require the same institutions to hold such instruments in order to maintain membership in an FHLB.

The NPR also conflicts with state laws related to permissible investments by mortgage insurance companies (MIs). Most states place strict limits on the amount of mortgages and mortgage-backed securities that MIs can hold because MIs are primarily engaged in insuring against mortgage credit defaults.<sup>3</sup> Thus, the quantitative limits if adopted would make it difficult, if not impossible, for MIs to qualify for membership in an FHLB. This is a particular concern to MIs, as some FHLBs engage in a range of mortgage-

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<sup>2</sup> 79 Fed. Reg. 61440, Oct. 10, 2014.

<sup>3</sup> See, for example, 50 Ill. Adm. Code § 202.60(d) and Wis. Adm. Code Ins. § 3.09(6). See also §7 of the NAIC’s Mortgage Guaranty Insurance Model Act.



related programs of interest to MIs. The Chicago FHLB, for example, is acting as an aggregator for Fannie Mae and Freddie Mac and has established a similar aggregator relationship with a private firm to aggregate jumbo loans, is exploring becoming a Ginnie Mae issuer and has created programs in which credit and interest rate risk are shared between a member and the Chicago FHLB. Participation in these non-advance initiatives may be strategically important to MI, yet may not be possible given the conflict between state insurance investment limitations and the NPR's proposed quantitative standards.

In sum, compliance with the quantitative standards proposed in the NPR can lead to non-compliance with the other regulations and expose an institution either to penalties by a federal or state regulator or the loss of membership in an FHLB.

The proposal also would reduce flexibility in balance sheet management as members seek to maintain sufficient mortgage related assets on their balance sheet, while at the same time satisfying risk management objectives and complying with other regulatory requirements. These tensions would make access to FHLB liquidity far less certain for members. Further, the current framework used to ensure FHLB lending is consistent with the mission of the FHLB System and is effective in that member banks can only borrow when they pledge eligible collateral. This method provides member banks with flexibility to manage their balance sheets while ensuring focus on the System's housing related mission.

In conclusion, these conflicts and challenges could be avoided by the elimination of the proposed quantitative standards, which we recommend. Alternatively, if FHFA decides to implement the proposed or similar quantitative standards, we urge FHFA to establish a safe harbor for institutions that are subject to the LCR regulation, state insurance investment limitations and other federal or state financial or solvency standards that are inconsistent with the quantitative standards.

#### The Proposed Definition of the Term "Insurance Company" is Not Consistent with the Common Meaning of that Term

We acknowledge that FHFA, as the agency responsible for implementing the Federal Home Loan Bank Act (the Bank Act), has the authority to define terms in the Bank Act in order to give purpose and intent to the Bank Act. In doing so, however, FHFA must adhere to standard principles of statutory interpretation, and those principles do not support the definition of the term "insurance company" that is proposed in the NPR.



It is a basic canon of statutory interpretation that an agency should apply the established, or common, meaning to an undefined term.<sup>4</sup> In this case, the definition of the term “insurance company” that is proposed in the NPR is not the common meaning of the term “insurance company.” The term is commonly understood to refer to a company that is engaged in the business of underwriting insurance risks. The common meaning of the term “insurance company” does not distinguish between classes or categories of persons, as does the definition proposed in the NPR. Separate terms are used to define insurance companies that underwrite specific risks. For example, a life insurance company issues life insurance policies; a property and casualty insurance company issues property and casualty insurance policies and a mortgage insurance company issues mortgage insurance.

The common meaning of the term “insurance company” may be found in legal dictionaries and other federal laws. The Fourth Edition of Barron’s Dictionary of Insurance Terms defines the term “insurance company” to mean “an organization that underwrites insurance policies.”<sup>5</sup> The Securities Act of 1933 defines the term to mean “a company which is organized as an insurance company, whose primary and predominant business activity is the writing of insurance or the reinsuring of risks underwritten by insurance companies, and which is subject to supervision by the insurance commissioner, or a similar official or agency, of a State or territory or the District of Columbia; or any receiver or similar official or any liquidating agent for such company, in his capacity as such.”<sup>6</sup> The Bank Holding Company Act of 1956 defines the term to include “any person engaged in the business of insurance to the extent of such activities.”<sup>7</sup>

The common meaning of the term also may be found in state law, and such laws have particular relevance in this case because Congress, through the McCarran-Ferguson Act, has formally recognized that the states have primary authority over insurance companies.<sup>8</sup> Virginia, for example, defines an “insurance company” as any company in the business of making contracts for insurance.<sup>9</sup>

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<sup>4</sup> See, for example, *FDIC v. Meyer*, 510 U.S. 471, 476 (1994) (“In the absence of such a definition, we construe a statutory term in accordance with its ordinary or natural meaning.”). See also, *Community for Creative Non-Violence v. Reid*, 490 U.S. 730, 739 (1989) (“It is, however, well established that ‘[w]here Congress uses terms that have accumulated settled meaning under the common law, a court must infer, unless the statute otherwise dictates, that Congress means to incorporate the established meaning of these terms.’” Citing *NLRB v. Amax Coal Co.*, 453 U.S. 322, 329 (1981))

<sup>5</sup> Dictionary of Insurance Terms, Fourth Edition, Barron’s Educational Services Inc. (2000)

<sup>6</sup> 15 U.S.C. 77b(13).

<sup>7</sup> 12 U.S.C. 1841(q)

<sup>8</sup> 15 U.S.C. 1011 et seq.

<sup>9</sup> Virginia Code § 38.2-100.



Finally, and most importantly, when faced with an almost identical question of statutory interpretation, the U.S. Supreme Court found that the term “insurance company” has a common meaning, and absent any indication to the contrary, “there is no warrant for holding that Congress intended to use the expression in any other sense.”<sup>10</sup> That case involved an interpretation of the undefined term “insurance company” as used in the Internal Revenue Code. Subsequently, the Internal Revenue Service amended its regulations to define the term “insurance company” in a manner consistent with its common meaning.<sup>11</sup>

In sum, when Congress included the term “insurance company” in the Bank Act, there is no indication that it intended the term to be interpreted in any manner other than as it is commonly understood and not as proposed in the NPR. Thus, we urge FHFA to reconsider the definition of “insurance company” proposed in the NPR.

Again, our members strongly support the Federal Home Loan Bank system and we recognize the important goal of ensuring that it is meeting its mission. We ask that the Federal Housing Finance Agency consider the recommendations we have made on the quantitative standards and their relationship to other regulatory safety and soundness requirements, as well as the definition of insurance company in the NPR. Thank you for the opportunity to present these views.

Sincerely,

John H. Dalton  
President  
Housing Policy Council of the Financial Services Roundtable

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<sup>10</sup> *Bowers v. Lawyers Mortgage Co.*, 285 U.S. 182, 190 (1932)

<sup>11</sup> Treas. Regs. § 1.801-1(b)(2).