MIDCOUNTRY BANK

January 12, 2015

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

Re: <u>Notice of Proposed Rulemaking; Request for Comments – Members of the Federal Home Loan Banks</u>

Dear Mr. Pollard:

We are submitting this comment to express our concerns about the Federal Housing Finance Agency's ("FHFA") notice of proposed rulemaking and request for comments on "Members of the Federal Home Loan Banks" published on September 12, 2014. For the reasons described below, we respectfully request the withdrawal of this proposal.

MidCountry Bank (the "Bank") is a community centered bank that has been in business for over 10 years as a result of the acquisition of four separate bank and thrift institutions in Southern Illinois and Central Minnesota. Currently, we operate 13 retail bank branch offices in Central Minnesota, both in urban and rural areas, eight retail bank branches in primarily rural Southern Illinois, and one branch location in Nevada. We operate with nearly $703 million in total assets and represent a vital source of lending to the communities that we serve, providing loan products for residential real estate, commercial real estate, small business, agricultural real estate and operating loans, as well as various other loans to consumers. We are also active in the leasing business to smaller businesses. We have been a member of the Federal Home Loan Bank of Chicago ("FHLBC") since entering the Southern Illinois market and we were a one time a member of both the FHLBC as well as the Federal Home Loan Bank of Des Moines until we later consolidated our membership into the FHLBC. As permitted under the Federal Home Loan Bank Act (the "FHLB Act"), we use our various loans as collateral to support our activities with the FHLBC and have found the FHLBC to be an outstanding partner in safekeeping assets, assisting us in providing affordable housing to the communities in which we serve, providing liquidity to the Bank at important times as well as providing products that allow us to better manage the inherent interest rate risk of our balance sheet. The FHLBC and its employees have been an outstanding partner over the years and we greatly value our current relationship and membership.

As noted, as a shareholder and customer, we greatly value our membership in the FHLBC and view it as a key partner to help us better serve our customers and our community. For a smaller bank such as ours, access to FHLBC advances is critically important because the liquidity allows us to offer an array of loan products to our customers that we might not otherwise be able to offer. The FHLB's products such as advances, letters of credit and the Mortgage Partnership Finance® Program are tremendous resources that enable us to effectively compete with much larger financial institutions, resulting in more choices and better service for our consumer, small business and agricultural customers.

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EQUAL HOUSING LENDER

The proposed rule concerns us because it would impose, for the first time ever, on-going requirements for our bank to meet as a condition of remaining a member of the FHLBC. For community financial institutions ("CFIs"), such as our bank, the proposal would require us to hold between one percent to five percent of our total assets in long-term home mortgage loans. Failure to maintain this level would result eventually in the termination of our membership in the FHLBC.

While this requirement may not appear to the FHFA to be onerous, particularly on our Bank today, the practical consequences would be very severe and disruptive. To begin with, our ability to rely on the liquidity provided by the FHLBC, particularly in times of economic distress which remains vivid in our memory, would be seriously undermined if the FHFA is allowed to establish requirements we must meet simply to remain an FHLBC member. This has never been the case in the 82-year history of the FHLBs. Membership in the FHLBs has been steadily expanded by Congress over the years, never contracted. With the imposition of such a requirement, we could never be assured that when the next financial crisis occurs we will have continued access to FHLBC liquidity and particularly at an affordable and effective level to ensure unaffected or uninterrupted operations during such a crisis.

Even if we met the proposed threshold as we do today, we would need to manage our balance sheet with the proposed requirements in mind going forward. Future decisions regarding our asset allocation would need to bear them in mind. Our asset allocation potentially would become over-invested in housing related assets at the expense of small business lending and other commercial loans, consumer loans or other asset classes. In effect, a portion of our balance sheet would be dictated by the FHFA. This result would contradict the intent of Congress, which specifically allowed CFIs to pledge small business, agricultural and agri-business loans as collateral for FHLB advances under the Gramm-Leach-Bliley Act of 1999 ("Act"). By making clear that CFIs may use FHLB funding for purposes other than residential housing finance, the Act expanded the mission of the FHLBs and encouraged lending by smaller depository institutions to these asset categories. The proposed rule contradicts this Congressional intent by mandating CFIs hold some amount of our assets in long-term home mortgage loans. It does not appear to recognize the legitimate uses of FHLB funding beyond housing finance activities.

This proposal also could inhibit our ability to grow, or threaten our access to the FHLBC if we do. For example, if our total assets grow above the current CFI threshold of $1.108 billion, either organically or through acquisition, our Bank would then become subject to the additional proposed on-going test that would require us to maintain 10% of our assets in residential mortgages loans. This could have the unintended consequence of forcing us to forego expansion or merger plans for the sole purpose of maintaining our FHLB membership. As a result of trying to avoid crossing the arbitrary CFI limit, we might need to reduce our usage of FHLB products and services, which in turn could reduce the products we are able to offer our customers and serve our communities. As a regulator, the FHFA undoubtedly understands the importance and necessity of asset growth for a bank. Prudently growing assets generally is a sign of a healthy institution and can contribute to a sounder overall financial system. The FHFA should support the reasonable growth of FHLB members and avoid penalizing them or threatening our access to FHLB liquidity as a result of such growth under the auspices of effective balance sheet management, dictated only by the inherent risks and opportunities that are driven by the current economic environment.

We also are very concerned this proposal 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 that a sufficient housing finance nexus is maintained at all times by members with the unintended consequence of reducing and weakening the system and its ability to support its members as it so aptly did during the "Great Recession" and thereafter.

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, potentially including our bank, 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 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 FHLBC, 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, negatively impacting our Bank. Additionally, as usage contracts and profits decline, fewer dollars will be available to support the FHLBC's affordable housing and community investment programs, not to mention the cost effective nature of their products for liquidity and interest rate risk management purposes. Our Bank's ability to serve our community through our valuable products with the assistance of these products as well as the FHLB's down payment assistance grants, Community Investment Cash Advances and Affordable Housing Program grants would be harmed.

Beyond these destabilizing effects, this proposal does nothing to help strengthen the overall financial system. Since the financial crisis, our prudential regulators, the OCC, have increasingly emphasized liquidity planning in an effort to prevent another crisis from occurring. In our liquidity and contingency funding plans, we greatly rely on our access to the same-day funding offered by the FHLBC. Our regulator understands and accepts the vital role of the FHLBs in such planning. This proposal contradicts these efforts by undermining the reliance of banks such as ours on the FHLBs. In so doing, it threatens to weaken the broader financial system while doing nothing to help prevent a repeat of the most recent financial crisis.

Nor does the proposal do anything to help repair and restart the struggling housing markets. Many community banks rely upon the FHLBs' MPF® Program to access the secondary mortgage market. This innovative program has been popular with FHLB members, particularly smaller community banks, because it allows smaller mortgage originators to access the secondary mortgage market on competitive terms while retaining their customer relationships. The traditional MPF products also pay participating 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. Also, if long-term mortgages are held by members, the interest rate risks of their balance sheets will be increased, which for some could be severe. Moreover, to the extent the proposal discourages FHLB membership or terminates existing

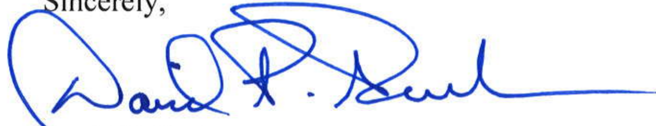
memberships, it will only limit access to housing finance and the secondary market. Again, this seems to directly contradict the efforts of the Administration and others to increase the availability of mortgage credit, particularly for lower income families.

This proposed rule further harms the financial system by adding to the growing regulatory burden on small banks that impedes our ability to efficiently operate our businesses and best serve our customers and shareholders. Community banks across the country are struggling under the weight of an extensive regulatory regime imposed upon us in recent years, despite the fact that we were not the cause of the financial crisis. Recent legislative and regulatory requirements include the Patriot Act, the Bank Secrecy Act, anti-money laundering rules, the Dodd-Frank Act and accompanying Qualified Mortgage and Qualified Residential Mortgage rules, and new Basel III-like capital and liquidity requirements. This proposal only adds to this burden and may cause us to rethink the practicality of remaining a FHLB member versus other less onerous options in the future.

In conclusion, we view the FHLBC as a critical partner for our bank. Its reliability as a liquidity source must be preserved. Threatening access to the FHLBC threatens our bank, our customers and the communities in which we serve. This proposal would undermine the reliability of the FHLBC, discourage membership, politicize FHLB membership, limit access to the secondary market and shrink the FHLBC's affordable housing and community development activities, all likely impacting our growth. It also will do nothing to help the effort of other banking regulators to strengthen the overall financial system or repair the struggling housing markets. Despite these real and damaging effects, there appear to be no specific benefits that would be achieved by this proposal. The costs clearly outweigh the benefits. For these reasons, we strongly urge the immediate withdrawal of this proposal.

We appreciate the consideration of our views.

Sincerely,



David P. Turk
Chief Financial Officer
MidCountry Bank