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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:

The American Bankers Association[1] is pleased to provide the following comments to the Federal Housing Finance Agency (FHFA) regarding the proposed changes to the membership requirements for the Federal Home Loan Bank System (FHLB or System).

The FHFA has requested comments on a notice of proposed rulemaking (NPRM) regarding membership eligibility requirements for the FHLB System. The NPRM states that it seeks to address the System's housing finance mission and in doing so would fundamentally change the nature of the System in ways not authorized or approved by Congress. We recognize the FHFA's role in ensuring that the FHLBs continue to meet their mission, and share in concerns that the mission not be distorted through inappropriate access to System liquidity or other services. The approach taken by the FHFA in the NPRM to address these concerns, and indeed the basis for some of the concerns raised by the NPRM is fundamentally flawed, running counter both to Congressional intent for the System and to the plain meaning of the Federal Home Loan Bank Act (the Act). We detail our issues with the approach taken in the NPRM below and urge the FHFA to withdraw the rulemaking so that substantial changes can be made before moving forward.

The Proposed Rule's New Membership Requirements

The NPRM would revise the FHLB membership rules in two fundamental ways. It would impose, for the first time in the history of the System, on-going mortgage asset tests – with different tests for members of different sizes, and would alter the definition of insurance company to exclude captive insurance companies from membership in the System.

Under the NPRM all FHLB members would be required to hold, on an ongoing basis, one percent of assets in "home mortgage loans" as defined by the FHFA in order to satisfy the requirement that an institution make long term home mortgage loans. Further, all depository institutions that are not Community Financial Institutions (CFIs) – defined by FHFA as depository institutions at or below $1.108 billion in assets – must also comply with an ongoing requirement that at least ten percent of their total

[1] The American Bankers Association is the voice of the nation's $15 trillion banking industry, which is composed of small, regional, and large banks that together employ more than 2 million people, safeguard $11 trillion in deposits, and extend more than $8 trillion in loans. ABA's members represent the full range of federally insured banking institutions and their subsidiaries and make up most of the members of the Federal Home Loan Bank System.

assets are in "residential mortgage loans" as defined by FHFA. The current test to ensure that eligible members make home mortgage loans is a one-time test upon application for membership. A prospective member must demonstrate that it has such long-term mortgage assets on its books at the time of application but has never before in the history of the System been required to comply with an ongoing test. Under the NPRM members found to be out of compliance (based on a rolling three year average) would be given one year to return to compliance. If the member remains out of compliance for two consecutive years, their membership would be terminated and would be cut off from all FHLB liquidity and services.

Additionally, captive insurance companies would be deemed ineligible for membership in the System and would be forced out of the System if the proposal were to take effect. The NPRM would effectuate this change by redefining "insurance company" not to include captive insurers, even though the Federal Home Loan Bank Act – the authorizing statute – states that all insurance companies are eligible members.

The NPRM runs counter to the clearly authorized mission activities of the System and to the plain meaning of the authorizing statute with regard to eligible members of the System.

Chartered by Congress in 1932 to provide liquidity for housing finance to what were then known as building and loan institutions (now savings associations) and insurance companies – the primary lenders for mortgage finance at the time, the scope of eligible membership in the System and the mission of the System have consistently been expanded by Congress in the intervening eighty two years. In 1989 membership was expanded by Congress to all federally insured depository institutions, including commercial banks and credit unions. In 1999 and in 2008 Congress expanded the categories of collateral eligible to be pledged by members for FHLB liquidity and in 2008 Congress formally recognized the FHLB's role in providing liquidity to their members without limiting that purpose to housing finance. Today, as the FHFA noted in the FHFA Strategic Plan: Fiscal Years 2015 – 2019, the Federal Home Loan Banks' "core mission is to serve as a reliable source of liquidity for their member institutions in support of housing finance and community lending."

In recent years, the FHFA has also acted to further authorize additional categories of collateral beyond those tied to housing finance, including federally insured student loans (authorized in 2009) and loans made by Community Financial Institution members of the System for community development purposes in 2010.

These actions, both Congressional and regulatory, make clear that the mission of the FHLB System has been expanded beyond housing finance. Inexplicably, the FHFA has proposed this rule in an apparent attempt to reestablish a nexus between FHLB membership requirements and the mission of the System as established by Congress. However, the rule would have the effect of substantially limiting the mission of the Federal Home Loan Banks in providing reliable liquidity to their members. By focusing membership requirements solely on residential mortgage loans and home mortgage loans, the rule ignores the many other categories of mission related assets a member may hold on its books.

As to the definition of insurance company, the authorizing statute is clear. All insurance companies are eligible for membership, just as all federally insured depository institutions are eligible. For the FHFA to decide on its own that it can redefine the meaning of "insurance company" to exclude captive insurers sets a dangerous precedent. FHFA could potentially determine that "federally insured depository" no longer has the same meaning for a commercial bank or a credit union as it does for other institutions.

The NPRM is harmful to the Federal Home Loan Banks, their members and the communities they serve.

The NPRM will make access to Federal Home Loan Bank liquidity far less certain. The imposition of on-going asset tests will result in member banks being unable to be certain of their future ability to meet the tests in all market conditions and maintain their membership and borrowing ability, especially in times of financial stress when asset values can erode rapidly. Uncertainty over the ability to borrow will harm the member bank's safety and soundness standing with their prudential regulator. Additionally, member banks will face reduced flexibility in balance sheet management as they strive to ensure they hold the required mortgage assets on their books, even if other financial regulators express concern over holding greater amounts of mortgage assets on balance sheets. These problems are likely to be especially acute for banks that are approaching the Community Financial Institution (CFI) asset cap. A CFI that exceeds that cap, either through growth or merger, would be required to meet the 10 percent residential mortgage test or lose their FHLB membership. Thus, as they grow, the will have to distort their balance sheet management or face uncertainty as to their continued ability to borrow from the System, or both. A CFI that acquires another bank with fewer mortgage assets could fail the new test despite the fact that it may have increased its overall commitment to residential mortgage finance.

Uncertainty over continued membership eligibility also harms the entire Federal Home Loan Bank System. As members fall out of eligibility, their stock in the FHLB must be redeemed, destabilizing the capital of the individual Banks, and because the System is a joint and several one, of the entire FHLB System. While this may seem relatively inconsequential on an individual bank basis, taken as a whole, with members falling in and out of membership and in and out of their stock contribution, the entire System will be viewed by the prudential regulators and the capital markets as less stable and reliable.

Furthermore, the proposal does not address a number of troubling questions surrounding members that fall out of eligibility. Would these members be subject to the current five-year prohibition on readmission, or would they be allowed to rejoin as soon as they were able to demonstrate compliance with the new requirements? The rule also does not address stock redemption, leaving uncertainty over the timing of stock redemption for a member falling out of compliance.

With less certainty over future availability of liquidity, banks may pull back from financing certain projects and investments, harming the communities they attempt to serve. A community that might benefit from a bank's growth or merger could suffer if that growth was stifled due to concerns over continued membership eligibility.

Based on data from the Council of Federal Home Loan Banks, 5,622 current FHLB members have been CFIs, but only 5,253 have consistently been CFIs. That means that 369 member banks have moved in and out of CFI status in that time. These banks, and likely more in the future, would face great uncertainty going forward due to the new 10 percent asset test.

The proposal is perhaps most harmful to Community Development Financial Institutions (CDFIs) which Congress authorized as FHLBank members under the Housing and Economic Recovery Act of 2008 (HERA), and for which FHFA issued final regulations in 2010. This expanded eligibility would be seriously undercut by the proposed rule. CDFI's are specialized lenders focused on community development as their name implies. If required to meet the ongoing 1 percent of total assets in narrowly defined housing related assets (as opposed to a broader category of otherwise eligible collateral) CDFIs may face great difficulty in either carrying out the mission for which they were chartered. Many CDFIs hold participations in loans, including participations in loans to developers of affordable housing. These participations would not count toward the 1 percent test. These CDFIs would face possible expulsion

from the System, limiting their funding sources, and running counter to the clear intent of Congress. Such a result would also have the consequence of further limiting funding for further development of affordable housing. Surely this cannot be the outcome the FHFA desires.

With regard to captive insurance companies, an outright ban not only runs counter to the clear language of the authorizing statute (as discussed above) but would remove from the System members who are engaged in lending and other activities that provide a substantial benefit to their communities, as well as to the members of the Federal Home Loan Bank System. For example, one captive insurance company member provides servicing activities to the other members of their Federal Home Loan Bank. Having another member of the System provide reliable, quality servicing of loans is a benefit to the members of the System and the customers they serve. Imposition of the new rule would put those services at risk if not eliminate them entirely.

There is no demonstrable need for the changes proposed.

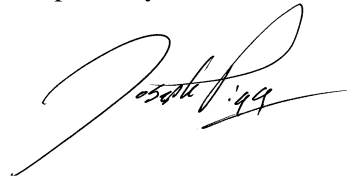
The current method employed by the System to ensure that members engage in mission related lending is far superior to the tests proposed under the NPRM. Under the current method, a member may only borrow from a FHLB if it has eligible collateral to pledge. If a member does not make sufficient mission related loans, or hold sufficient mission related assets, it will not have collateral to pledge and will not be allowed to borrow further. This method is both efficient and elegant as it requires no on-going tracking and allows member institutions maximum flexibility while still ensuring that the System and its members remain focused on the broader mission of the System.

The proposed on-going asset tracking, however, will add regulatory burden for the Federal Home Loan Banks, the costs of which will undoubtedly be passed along to the members who borrow from the System, and ultimately to the customers of those member banks. The end result will be higher costs for credit. This could perhaps be justified if there was an urgent need to ensure or restore mission focused lending by the FHLBs and their members, but as the FHFA has admitted, there is no showing of such a need, as the System and its members consistently lend in a mission focused manner. It should also be noted that given the still fragile state of the American housing economy, now is not the time to impose further (and unnecessary) hurdles and higher costs on mortgage and housing related lending.

With regard to captive insurance companies, as we noted at the outset, we do share the FHFA's concerns that some entities may be using captive insurance companies to join the System and gain access to liquidity that would otherwise be unavailable. There are better, more targeted means of addressing this concern than simply banning all captive insurers from being members of the System. It should be noted that the FHLBs already impose significant constraints on the borrowing ability of insurance company (including captive insurers) members of the System that go beyond those imposed on insured depositories. These include higher collateralization rates, and actual delivery of collateral to the FHLB. There are currently only a few captive insurance company members of the System, and each has differing reasons for their membership. Rather than redefine captives out of membership eligibility (again, in contravention of the authorizing statue), a better approach is to require each of the FHLBs to impose controls over borrowing ability and collateral requirements to address any concerns raised by an individual captive member's intended or actual use of the System.

Conclusion

The importance of the Federal Home Loan Banks as a source of liquidity and other services to our member banks cannot be overstated. For that reason it is essential that the FHLB System remains well regulated and appropriately focused. While ABA appreciates and respects the FHFA's role in maintaining the safety, soundness and mission integrity of the System, we differ strongly with the direction taken by the FHFA on the membership proposal. We urge the FHFA to withdraw the NPRM. While we agree that some of the issues raised by the NPRM need to be addressed, particularly those relating to the use of captive insurance companies to access System advances, there are more targeted ways to address those concerns. We urge the FHFA to revise this proposal so that it better reflects both the congressionally defined mission of the System and the authority granted to the FHFA to ensure that the System and its members meet that mission. If you wish to discuss any of our comments in more detail, or have questions, please contact the undersigned.
Respectfully submitted,



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