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## MEMORANDUM

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FROM: Alston & Bird LLP

DATE: September 28, 2015

RE: Insurance Companies and the Federal Home Loan Bank Act

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The Federal Home Loan Bank system (the “Bank”) is a system of 11 government-sponsored banks<sup>1</sup> that provide on-demand funding for the financing of housing and community lending. Funding is only available to entities that are members of the Bank. The Federal Home Loan Bank Act of 1932 (the “Bank Act” or “Act”), which created the system and governs membership in the Banks, states that “[a]ny . . . insurance company . . . shall be eligible to become a member of a Federal Home Loan Bank”. Based on the plain language of the Bank Act, all types of insurance companies are permitted to be Bank members. The legislative history concerning Bank membership and the Bank Act’s purpose also support the conclusion that all types of insurance companies should be granted membership to the Bank.

On September 12, 2014, the Federal Housing Finance Agency (the “FHFA”) published a notice of proposed rulemaking and request for comments (the “NPR”) that proposed restricting the term “insurance company” to mean only companies “whose primary business is the underwriting of insurance for *nonaffiliated* persons or entities”.<sup>2</sup> This interpretation is inappropriate because it excludes captive insurers from Bank membership, which is in contrary to the Act’s text and purpose. Further, the motivation behind the NPR is faulty: FHFA has never before looked through an entity to its parent to determine that entity’s eligibility.

When interpreting a statute, if the statute is unambiguous, then “the intent of Congress is clear”<sup>3</sup> and agencies must carry out Congress’s directive. However, when a statute is “silent or ambiguous” with respect to an issue, an agency has the authority to adopt a “permissible construction of a statute”.<sup>4</sup> A “permissible construction” is an interpretation that is “consistent with the structure and purpose” of act in question.<sup>5</sup> As noted below, the Bank Act is

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<sup>1</sup> There were originally 12 bank branches, however in 2015, the Seattle branch merged with the Des Moines branch.

<sup>2</sup> Members of Federal Home Loan Banks; Proposed Rule, 79 Fed. Reg. 54,848, 54,853 (proposed Sept. 12, 2014) (to be codified at 12 C.F.R. pt. 1263) (emphasis added).

<sup>3</sup> *Id.*

<sup>4</sup> Members of Federal Home Loan Banks, 79 Fed. Reg. 54,848, 54,852 (proposed Sept. 12, 2014) (to be codified at 12 C.F.R. pt. 1263) (citing *Chevron v. Natural Resources Defense Council*, 467 U.S. 837, 843 (1984)).

<sup>5</sup> Members of Federal Home Loan Banks, 79 Fed. Reg. at 54,852.

unambiguous: insurance companies are Bank members and the meaning of insurance company encompasses all types of companies that provide insurance. However, if we assume for the sake of argument that the Bank Act is ambiguous about which insurance companies are permitted membership, interpreting “insurance company” to exclude captive insurance companies is inconsistent with the structure and purpose of the Bank Act.

**I. LEGISLATIVE HISTORY MAKES IT CLEAR THAT CONGRESS INTENDED TO PERMIT MOST SIGNIFICANT MEMBERS OF THE HOME FINANCING INDUSTRY TO BE BANK MEMBERS.**

The legislative history of the Bank Act demonstrates that membership in the Bank should include most significant members of the home financing industry. When the Act was enacted, most significant members of the home financing field were permitted membership and Congress rejected proposed restrictions on Bank membership. It would be incongruous to now exclude a notable member of the housing finance industry, captive insurers, from Bank membership. Therefore, the only permissible construction of the term “insurance company” is a broad construction that includes captive insurers.

Further, legislative history concerning the Bank Act’s purpose makes it clear that the purpose of the Bank Act is furthered by permitting most significant members of the home financing industry to be Bank members. The Bank Act’s purpose, as shown through the intent of the drafters and in subsequent amendments, is to promote liquidity in the housing finance market.<sup>6</sup> In conjunction with that purpose, Congress has repeatedly encouraged broad Bank membership. Barring entities that are regular participants in the mortgage finance industry, such as captive insurers, from Bank membership is directly contrary to that legacy and the Act’s purpose.

Bank membership should be interpreted broadly, to include the wide spectrum of entities involved in the mortgage finance field. It is incongruous that Congress could have intended that “insurance company” be defined to exclude a member of the housing finance industry.

***Supporting evidence:***

Congress and the President both emphasized broad Bank membership when the Bank Act was enacted. When the House passed the Bank Act, it noted in the House Report accompanying the Act that funding was to be available to most significant members of the housing industry, including all “building and loan associations, cooperative banks, homestead associations, savings banks, trust companies, and other banks with time deposits . . . and insurance companies subject to inspection and regulation under the banking laws or similar laws of the State or the United States”.<sup>7</sup> Further, throughout the House Report, potential Bank members are referred to interchangeably as “home-financing institutions”, “home loan banking units” and “home

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<sup>6</sup> The Bank Act’s purpose is discussed in greater detail in Section III of this memo.

<sup>7</sup> H.R. Rep. No. 72-1418, at 4 (1932).

mortgage institutions”, with such phrasing indicating Congress’s desire for broad Bank membership.<sup>8</sup>

Additionally, President Herbert Hoover highlighted broad Bank membership in his signing statement, stating that “[b]uilding and loan associations, savings banks, insurance companies, etc. are to be eligible for membership in the system”,<sup>9</sup> with the word “etc.” emphasizing that numerous types of members were contemplated. Similarly, he noted the Act had been enacted because restrictions on credit had impacted all entities in the home financing industry, including “building and loan associations, savings banks, and other institutions making loans for home purposes”.<sup>10</sup> Finally, he stated that the goal of the Bank was to bring “into continuous and steady action the great home loaning associations”,<sup>11</sup> indicating the importance of ongoing support for most significant members of the “home loaning” industry.

Restricting Bank membership was discussed and rejected by the House. Four House representatives believed the Act should not provide funding to “State banks, trust companies, or other banking organizations”, as such entities had access to funding from other sources.<sup>12</sup> The House considered prohibiting these types of entities from accessing the Bank but ultimately rejected the idea in favor of offering membership to most significant “home-financing institutions”. Additionally, in 1932 when such membership restrictions were contemplated, no mention was made of restricting the types of insurance companies that could obtain Bank funding.<sup>13</sup> Since that date, Congress has reaffirmed this approach by declining to regulate captive insurers in other contexts as well.<sup>14</sup>

## **II. BASED ON THE PLAIN LANGUAGE OF THE BANK ACT, CONGRESS INTENDED THAT THE TERM “INSURANCE COMPANY” ENCOMPASS ALL TYPES OF INSURANCE COMPANIES.**

The FHFA’s proposed definition, which restricts “insurance companies” to companies “whose primary business is the underwriting of insurance for nonaffiliated persons or entities”,<sup>15</sup> runs contrary to the ordinary meaning of the term and prior agency interpretation, and as a result, it should be rejected. The plain language of the Act encompasses all types of insurance

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<sup>8</sup> See H.R. Rep. No. 72-1418.

<sup>9</sup> Herbert Hoover: “Statement About Signing the Federal Home Loan Bank Act”, July 22, 1932. Online by Gerhard Peters and John T. Woolley, *The American Presidency Project*. <http://www.presidency.ucsb.edu/ws/?pid=23176>.

<sup>10</sup> *Id.*

<sup>11</sup> *Id.*

<sup>12</sup> H.R. Rep. No. 72-1418, at 13.

<sup>13</sup> *Id.*

<sup>14</sup> See 15 U.S.C. §§ 1011-15 (2006) (the McCarran-Ferguson Act allows states to regulate insurance and partially exempts insurance companies from federal anti-trust legislation).

<sup>15</sup> Members of Federal Home Loan Banks; Proposed Rule, 79 Fed. Reg. at 54,853.

companies. Based on contemporary dictionary definitions and existing staff guidance, the meaning of “insurance company” is a company that provides insurance. The meaning includes no qualification for whether insurance is provided to affiliated or nonaffiliated persons. As a result, the FHFA’s proposed definition of “insurance company” should be rejected as an unreasonable interpretation of the plain language of the Bank Act.

***Supporting evidence:***

The Bank Act states that “insurance companies” are eligible to be Bank members. Congress included no further definition for the term “insurance company” when the Bank Act was enacted. At that time, and in future amendments, Congress had the opportunity to define the term “insurance company”. Congress created definitions for other types of members, such as “insured depository institutions”.<sup>16</sup> But they never defined the term “insurance company”. Therefore, Congress intended to the term “insurance company” to be given its “ordinary, contemporary, common” meaning.<sup>17</sup>

Under common understanding, insurance company is a broad term. Black’s Law Dictionary defines “insurance company” as “[a] corporation or association whose business is to make contracts of insurance”.<sup>18</sup> Webster’s Dictionary contains no definition for “insurance company” but defines “insurer” broadly as “one that contracts to indemnify another by way of insurance; an insurance company or underwriter”.<sup>19</sup> Further, prior published staff guidance from the Federal Housing Finance Board<sup>20</sup> considered the term “insurance company” and determined that it should be interpreted broadly to mean “an underwriter of insurance”.<sup>21</sup>

**III. THE PRIMARY PURPOSE OF THE BANK ACT IS TO CREATE A LIQUID HOUSING MARKET, AND PERMITTING CAPTIVE INSURERS TO REMAIN BANK MEMBERS FURTHERS THAT GOAL.**

Excluding captive insurers from membership should be rejected as an unreasonable interpretation of the Bank Act and contrary to the Act’s purpose because captive insurers further the Bank Act’s purpose of promoting liquidity in the housing finance industry. The primary

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<sup>16</sup> See Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (“FIRREA”), Pub. L 101-73 § 709, 103 Stat. 183 (amending the Bank Act to add the language “or any insured depository institution (as defined in section 2 of this Act)”).

<sup>17</sup> *Perrin v. United States*, 444 U.S. 37, 42 (1979) (noting that “[a] fundamental canon of statutory construction is that, unless otherwise defined, words will be interpreted as taking their ordinary, contemporary, common meaning”).

<sup>18</sup> BLACK’S LAW DICTIONARY 807-08 (6th ed. 1990).

<sup>19</sup> WEBSTER’S THIRD NEW INTERNATIONAL DICTIONARY 1173 (1967).

<sup>20</sup> The Federal Housing Finance Board was the precursor to the FHFA and oversaw the Banks from 1989 to 2008.

<sup>21</sup> FHFBB, Op. Gen. Counsel, 1998-GC-12, at 1 (Sept. 18, 1998), available at <http://www.fhfa.gov/SupervisionRegulation/LegalDocuments/Documents/FHFBB-General-Counsel-Opinions/1998/1998-GC-12.pdf>.

purpose of the Bank Act is creating a liquid housing market and permitting captive insurers to remain Bank members furthers that goal. When the Act was enacted, Congress and the President both emphasized the importance of making funds available to keep the housing market running smoothly. Prior Congresses had also noted that such funding was needed, and since the Act's enactment, subsequent Congresses have reiterated this goal when enacting amendments to the Act. Since the recent crash of the housing market, the housing finance market has come under stress because many members of the housing finance industry have been unable to provide funding for mortgage origination. Captive insurers can enable this much needed liquidity. Narrowing the scope of membership would thwart the Bank Act's purpose.

***Supporting evidence:***

Congress made the goal of promoting liquidity clear when they passed the Bank Act in the wake of the 1930s financial crisis.<sup>22</sup> In the House Report accompanying the Act, the Committee on Banking and Currency stated that the Act was intended “to serve the small home owner and home buyer in the cities and small towns” by creating a “reserve system supplying short-term and long-time funds” to entities in the home financing field.<sup>23</sup> The goal of the Act was to provide funding “at low cost and in liberal amounts at all times” to protect homeowners from “the vicissitudes of the general money market”<sup>24</sup> and prevent the “drying up of mortgage money”.<sup>25</sup> It was expected that the funding provided could be used for numerous purposes, including refinancing, “paying taxes and insurance costs”, paying “for modernization, repairs and maintenance of existing homes” and building new homes.<sup>26</sup>

President Hoover, in his signing statement, also noted that the Act was intended to promote liquidity in the housing finance market. He stated that the Bank Act was designed to “at all times to encourage homeownership” by extending “credit for the acquirement of new homes”.<sup>27</sup> The Act's purpose, he said, was to bring home loaning associations into “continuous and steady action” by shielding them from financial “restrictions” and “pressures”.<sup>28</sup>

The Bank Act and its housing finance liquidity goals were widely supported when the Act was enacted. Legislation similar to the Bank Act had been under consideration as early as 1918, when the first Federal Home Loan Bank plan was proposed by William B. Wilson, the Secretary of Labor to President Woodrow Wilson.<sup>29</sup> Congress considered the 1918 proposal and,

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<sup>22</sup> See H.R. Rep. No. 72-1418.

<sup>23</sup> *Id.* at 3.

<sup>24</sup> *Id.* at 10.

<sup>25</sup> *Id.* at 4.

<sup>26</sup> *Id.*

<sup>27</sup> Herbert Hoover: “Statement About Signing the Federal Home Loan Bank Act”, July 22, 1932. Online by Gerhard Peters and John T. Woolley, *The American Presidency Project*. <http://www.presidency.ucsb.edu/ws/?pid=23176>.

<sup>28</sup> *Id.*

<sup>29</sup> Letter from Charles C. Lockwood, Chairman of the Joint Legislative Housing Committee to Governor Alfred E. Smith (June 1, 1919), in *PUBLIC PAPERS OF GOVERNOR ALFRED E. SMITH* 674 (J.B. Lyon Company, Printers, 1920),

while it ultimately declined to propose legislation,<sup>30</sup> it agreed that facilitating mortgage lending by “insurance companies, savings banks and other institutions” was of utmost importance.<sup>31</sup>

In the years since the Bank Act’s enactment, Congress has reiterated that the Bank Act is intended to create a liquid housing finance market. In 1989, Congress amended the Act to allow the Banks to “carry out their housing finance mission [and] remain adequately capitalized and able to raise funds in the capital markets”.<sup>32</sup> And again in 2008, Congress noted that the Bank’s mission remained “providing liquidity to members”<sup>33</sup> and preventing “the disruption of availability in mortgage finances”.<sup>34</sup>

#### **IV. CONCLUSION**

In conclusion, denying Bank membership to captive insurers is contrary to the legislative history, the plain language and the intent of the Act. The legislative history of the Bank Act demonstrates that Bank membership should be available to all members of the home financing industry, as Congress expressly authorized such membership when the Bank Act was enacted. Further, based on the plain language of the Bank Act, all types of insurance companies are permitted membership in the Bank, whether they provide coverage to affiliated or unaffiliated persons. Finally, the primary purpose of the Bank Act is to create a liquid housing market, and permitting captive insurers to remain Bank members furthers that goal.

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available at  
<https://play.google.com/books/reader?printsec=frontcover&output=reader&id=CHE4AAAAMAAJ&pg=GBS.PA7>.

<sup>30</sup> Federal Home Loan Banks, Harvard Business School – Baker Library Historical Collections (July 29, 2015 at 3:22 P.M.), [http://www.library.hbs.edu/hc/lehman/company.html?company=federal\\_home\\_loan\\_banks](http://www.library.hbs.edu/hc/lehman/company.html?company=federal_home_loan_banks) (noting that Congress declined to propose legislation because the prosperity of the 1920s “obscured the problems with housing finance”).

<sup>31</sup> Report of Joint Legislative Committee on Housing to Governor Alfred E. Smith (June 16, 1919) *in* PUBLIC PAPERS OF GOVERNOR ALFRED E. SMITH at 677, available at <https://play.google.com/books/reader?printsec=frontcover&output=reader&id=CHE4AAAAMAAJ&pg=GBS.PA7>.

<sup>32</sup> H.R. Conf. Rep. 101-222, 423-24, 1989 U.S.C.C.A.N. 432, 462-63.

<sup>33</sup> HERA § 1201, 12 U.S.C. § 4513.

<sup>34</sup> 110 Cong. Rec. E1,560 (July 25, 2008).