FHLBANKS
A NATION OF LOCAL LENDERS

June 4, 2018

Alfred M. Pollard
General Counsel
Federal Housing Finance Agency
Eighth Floor, 400 Seventh Street, SW
Washington, D.C. 20219

Re: Comments/Regulatory Review No. 2018-N-03

Dear Mr. Pollard:

On behalf of the undersigned Federal Home Loan Banks (each an "FHLBank" and collectively, the "FHLBanks" or "FHLBank System"), we appreciate this opportunity to comment on the Federal Housing Finance Agency's (the "Finance Agency") Notice of Regulatory Review (the "Notice"). In contrast to the issuance of regulatory guidance such as Advisory Bulletins, we believe that the 'notice and comment' regulatory process established under the Administrative Procedures Act, which allows for input from the FHLBanks as well as other interested stakeholders and members of the public, helps to create and sustain a system of rulemaking that is ultimately beneficial for the FHLBank System and its mission as a provider of liquidity. The FHLBanks believe that the Finance Agency should give due consideration as to whether regulatory topics are more appropriately addressed in the form of regulation or guidance.

The Notice solicits comments on how all Finance Agency regulations, except for those regulations adopted or substantially amended within the past two years, "may be made more effective and less burdensome". This letter seeks to identify the regulatory issues viewed by the FHLBanks as most in need of review and revision. We believe that, from a "cost/benefit" perspective, improvements in the areas described below could have a beneficial impact on the operations and performance of the FHLBank System.

Municipal Securities as Eligible Collateral - 12 C.F.R. § 1266.7(a)(4)

The FHLBanks recommend that the Finance Agency review its guidance with respect to municipal securities as eligible collateral and consider revising the regulations to add municipal securities to the list of specified categories of "other real estate-related collateral" that are eligible to secure advances.

Municipal securities serve an important purpose in the betterment of local communities. Currently, municipal securities are not listed as eligible collateral for advances in the Finance Agency's regulations but can be accepted to the extent that such municipal securities can be

classified as "other real estate-related collateral" under 12 C.F.R. § 1266.7(a)(4). Neither the Finance Agency's regulations nor the Bank Act define "other real estate-related collateral". However, Regulatory Interpretation 2003-RI-02[1] ("2003-RI-02") states that a municipal security may be accepted as other real estate-related collateral to the extent that the proceeds of such municipal security "have been or will be used to finance the acquisition, development or improvement of real estate (Real Estate Improvements)". 2003-RI-02 further provides that a FHLBank seeking to accept the outstanding principal balance of a municipal security as collateral to secure an advance must determine: (i.) whether the proceeds of the municipal security have been or will be used directly or indirectly to finance Real Estate Improvements; and (ii.) in the case of a mixed-use municipal security, what percentage of the proceeds has been or will be used to finance Real Estate Improvements. Where part of the proceeds of a municipal security are being devoted to "indirect 'soft costs' such as architectural, development and legal fees related to Real Estate Improvements," that portion of the outstanding principal balance of the municipal security qualifies as other real estate-related collateral if capitalized on the same basis as real estate under U.S. G.A.A.P. accounting principles.

The FHLBanks agree that municipal securities should be categorized as "other real estate-related collateral" and request that the Finance Agency memorialize the status of municipal securities as eligible collateral for advances in the regulations. In addition, the FHLBanks request that municipal securities be allowed to be pledged without a detailed review or percentage allocation of the proceeds since such a review process has significant limitations, and by their very nature, municipal securities benefit their communities and are consistent with the mission of the FHLBanks.

The FHLBanks note that it is not always feasible to determine the percentage of proceeds of certain mixed-use municipal securities that have been used to finance Real Estate Improvements. In practicality, the offering documents describing municipal securities vary significantly from transaction to transaction, and it is frequently challenging to make an accurate assessment regarding the extent to which proceeds are being used directly or indirectly for Real Estate Improvements. Some municipal securities are issued to fund a particular building or infrastructure project, and the use of proceeds in those offering documents may be easily identifiable. However, other securities, such as those that relate to multi-year municipal capital plans, contain offering documents that describe the use of proceeds at a high level. In those instances, it is clear that proceeds are being used to fund real estate and economic development, but the offering documents do not contain sufficient detail to support a precise percentage allocation. The FHLBanks must search through various levels of municipal documents, sometimes coming-up short and not being able to allocate any percentage of the proceeds to such a bond issuance due to the lack of backup documentation. The assessment is even more challenging in transactions that involve a refinancing or refunding of previously issued municipal securities.

[1] *See* Regulatory Interpretation 2003-RI-02, The qualification of securities issued or guaranteed by state or municipal governments or their political subdivisions (Municipal Securities) as "other real estate-related collateral" (March 28, 2003).

Given that the proceeds of most municipal securities are used for the financing of real estate or community economic development initiatives that can be deemed real-estate related, the FHLBanks respectfully request that the percentage allocation requirement for municipal securities be eliminated and that any municipal bond types that have general purposes that are not deemed to be real-estate related (e.g., student loan, pension plan or litigation settlement) be carved-out of the list of eligible collateral rather than continuing the requirement that the FHLBanks individually assess each municipal security. The FHLBanks also request that municipal securities, which have become an established form of eligible collateral through reliance on 2003-RI-02, be added to the list of other "other real estate-related collateral" in the regulations in order to formalize municipal securities as an acceptable type of collateral.

Redefine "Advances" for Purposes of the Independent Director Regulations to Specifically Exclude Housing Finance Agency Bonds

A. Background: FHLBanks and State Housing Finance Agencies (SHFAs) Share a Common Mission of Promoting Affordable Housing and Can Partner in Several Key Ways

A key way in which HFAs can partner with the FHLBanks is for HFA executives to serve as Independent Directors of the FHLBanks. HERA established experience requirements for FHLBank Independent Directors, including knowledge of one or more of the following areas: auditing and accounting, derivatives, or financial management. Additionally, HERA also established qualifications for Independent Directors to serve as Public Interest Directors (a subset of the Independent Directors). Public Interest Directors must have more than four years' experience representing consumer or community interests in banking services, credit needs, housing, or consumer financial protections. HFA executives with capital markets and financial management experience as well as extensive experience with affordable housing and credit needs in their states are uniquely qualified to serve as FHLBank Public Interest Independent Directors. Indeed, over the years, HFA executives have served as highly effective directors of various FHLBanks.

Another way in which FHLBanks have partnered with HFAs for decades is through the purchases of general obligation HFA Housing Bonds (such as taxable HFA general obligation bonds). State and local government agencies sell taxable HFA Housing Bonds (commonly known as Mortgage Revenue Bonds and Multifamily Housing Bonds), and use the proceeds to blend with tax-exempt bonds to expand HFA efforts to finance low-cost mortgages for lower income first-time homebuyers or the production of apartments at rents affordable to lower income families. In purchasing general obligation HFA Housing Bonds, an FHLBank's rights are the same as the rights of all other HFA bondholders. Additionally, the general obligation HFA Housing Bonds are not collateralized by a dedicated pledge of any assets to the FHLBank and the FHLBank has no defined security interest in any specific collateral. As a bondholder, an FHLBank is not in any way favored over any other bondholder. Because of the nature of these transactions, purchases of general obligation HFA Housing Bonds are considered unsecured

credit transactions for purposes of Finance Agency regulations[2]. FHLBank purchases of such marketable general obligation HFA Housing Bonds provide FHLBanks with a way to support affordable housing in their districts through their investment portfolios. It is for this reason that such HFA securities are eligible investments for FHLBanks under Finance Agency investment regulations.

B. Comment: The Finance Agency Should Engage in a Rulemaking to Define "Advances" for Purposes of the Independent Director Regulations to Expressly Exclude FHLBank Purchases of HFA Bonds from the Definition of "Advances"; Only Actual Secured "Advances" Meeting the Requirements of 12 C.F.R. 1264.2 and 1266.17 Should Be Included in the Definition

The Finance Agency requires all FHLBank Independent Directors to complete an initial Application and a Certification annually thereafter. One of the statutory eligibility requirements in becoming and remaining as an FHLBank Independent Director is not to serve as a director, officer, or employee of any member of a Bank, or of any person that receives advances from a Bank[3]. Based on these "conflicts of interest" standards, the types of transactions Congress and the Finance Agency intended to prohibit were those that fit the definition of "advances" from an FHLBank.

Finance Agency regulations establish a specific process for HFAs to become non-member housing associates of an FHLBank eligible to borrow advances from an FHLBank on a secured basis through the pledge of limited specific types of eligible collateral (as defined by Finance Agency regulations)[4]. Under these regulations, FHLBanks are authorized to make fully secured advances to HFAs as housing associates where such advances are secured solely by pledges of specific types of specified eligible collateral.

Neither the Finance Agency's Independent Director Forms nor the Director Regulations define the scope of "advances" for purposes of conflicts of interests. Consequently, this term could be interpreted to include other transactions between FHLBanks and HFAs such as FHLBank purchases of HFA general obligation bonds. The Finance Agency's existing general regulatory definitions limit "advances" to secured transactions. However, if the Finance Agency interprets "advances" more broadly for purposes of Independent Director conflicts of interests, this could severely impact HFAs and the FHLBanks in two aspects: (1) reduce the number of potential qualified FHLBank Independent Director candidates who are HFA executives; and (2) reduce or eliminate FHLBanks' purchasing of general obligation HFA Housing Bonds. Taking this approach would frustrate a core mission of the FHLBanks to support affordable housing in their respective districts.

It is important to note that the Finance Agency adopted the current Independent Director conflict of interest regulation after the enactment of HERA, which imposed the substantive eligibility criteria for Independent Directors as discussed above and eliminated more restrictive

[2] *See* Regulatory Interpretation 2002-RI-05, Obligations of State Housing Finance Agencies and Unsecured Credit Limitations (May 21, 2002).
[3] *See* 12 U.S.C. § 1427(a)(3)(iii) and 12 C.F.R. § 1261.10
[4] *See* 12 C.F.R. §§ 1264.2 and 1266.17.

limitations on eligibility for prior FHLBank independent directors, (which were directors appointed by the Federal Housing Finance Board). Additionally, the rulemaking process for the existing Independent Director conflict of interest regulation did not separately define "advances" for purposes of determining potential conflicts nor have the prior eligibility forms defined this term. In its rulemaking on this issue, the Finance Agency used the narrow term "advances", a term defined in 12 C.F.R. § 1266.1 as opposed to using broader terms such as "advances or other borrowing/debt transactions".

Additionally, as noted above, in Regulatory Interpretation 2002-RI-05, the Federal Housing Finance Board concluded that HFA bonds issued in most general obligation structures are unsecured credit obligations for Finance Agency regulatory purposes. The Independent Director conflict of interest rulemaking process did not provide an opportunity for comment on the scope of the term "advances" as used in the current regulation as there was no explanation or definition of the term "advances" included in that rulemaking. Consequently, given the affected stakeholders and the lack of prior rulemaking we believe that it is reasonable for the Finance Agency to engage in a notice and comment rulemaking process to define the scope of "advances" as used in the existing Independent Director conflict of interest regulation and the corresponding Independent Director Forms.

Due Organization Requirement - 12 C.F.R. § 1263.7

The Federal Home Loan Bank Act (the "Bank Act") provides that, to be eligible for membership, an applicant must be "duly organized under the laws of any State or of the United States."[5] Section 1263.7 of the Finance Agency's regulations provides that an institution "shall be deemed to be duly organized" if it is "*chartered* by a State or Federal agency" as a depository institution or insurance company, or "in the case of a CDFI applicant, is *incorporated* under State or Tribal law."[6] The word "chartered" suggests a charter granted by a regulatory authority (such as a bank charter granted by a state banking commissioner or the Comptroller of the Currency), and the word "incorporated" suggests organization through filing articles of incorporation with a state's secretary of state. By using these words, the Finance Agency's regulation unnecessarily suggests a narrower approach than permitted by the statutory "duly organized" language. Modern state law provides multiple ways of organizing business entities, such as through the use of limited liability companies and other organizational structures; and state insurance laws similarly establish multiple ways of organizing insurance companies. Because the FHLBanks do not believe that the Bank Act (or the Finance Agency) intended to restrict members from using any form of organizational structure that is permitted under the laws of their jurisdiction of organization, we suggest that Section 1263.7 be modified to read as follows:

> "An applicant shall be deemed to be duly organized, as required by section 4(a)(1)(A) of the Bank Act (12 U.S.C. 1424(a)(1)(A)) and § 1263.6(a)(1), if it is chartered, incorporated, or otherwise organized pursuant to the requirements of any applicable

[5] *See* 12 U.S.C. 1424(a)(1)

[6] *See* 12 C.F.R. § 1263.7 (emphasis added)

> State, Federal or Tribal law, and is licensed, certified, or otherwise authorized by State, Federal or Tribal law to engage in the business of a building and loan association, savings and loan association, cooperative bank, homestead association, insurance company, savings bank, insured depository institution or CDFI."

Financial condition requirement for…certain CDFI applicants – 12 C.F.R. § 1263.16 (financial performance standards for CDFI's)

The FHLBanks request clarification around 12 C.F.R. § 1263.16, which, among other things, prescribes the financial condition requirements for certain CDFI applicants. Specifically, 12 C.F.R. § 1263.16(b)(2) sets forth four "minimum financial standards" (net asset ratio, earnings, loan loss reserves and liquidity). The "financial standards" chosen by the FHFA were, at the time, based on accepted prudential standards (i.e. the "net asset ratio" mirrored the "Financial Ratios of Minimum Prudent Standards" used by the CDFI Fund). We request that this section be revised to allow for an FHLB to determine the appropriate underwriting criteria when evaluating whether a CDFI is financially strong and that advances can be safely made to the CDFI. Alternatively, if an FHLB is not permitted to determine the underwriting criteria for evaluating a CDFI then we suggest replacing the phrase *"most recent financial statements"* in 12 C.F.R. § 1263.16(b)(2)(i), (ii) and (iii) with *"financial statements delivered pursuant to subsection § 1263.16(b)(i) above"*, which section prescribes a CDFI applicant's required financial statement deliveries. Since section § 1263.1 defines "total assets" for a CDFI as *"those total assets contained in applicant's audited financial reports"*, there is a potential conflict with the references to *"most recent financial statements"* within the descriptions of the standards in §1263.16(b)(2). Our suggestion above would eliminate this conflict. Further, because the standards are rebuttable pursuant to §1263.17(d)(2), a FHLBank is ultimately required to assess financial condition to ensure compliance with §1263.6(a)(4). The requested clarification described above would eliminate the conflicting language without compromising the obligation of FHLBanks to make prudent decisions regarding CDFI applicants.

Regulatory Citation Observations

We respectfully request that the Finance Agency correct the following inaccurate citations related to the Minority and Women Inclusion regulation: (i) the references to §§ 1207.20 and 1207.21 in 12 C.F.R. § 1223.23(b)(20) should likely be deleted and replaced with §§ 1223.20 and 1223.21 respectively; (ii) the references to § 1207.3(b) in 12 C.F.R. § 1223.21(b)(9) should be deleted and replaced with § 1223.3(b); (iii) the reference to 1223.21(b)(6) in 12 C.F.R. § 1223.3(b) should be deleted and replaced with § 1223.22(b)(9); and (iv) the reference to §1207.21(b)(5) in 12 C.F.R §1261.9(c) should likely be deleted and replaced with §1223.21(b)(7).

Thank you for your consideration of these comments.

Sincerely,

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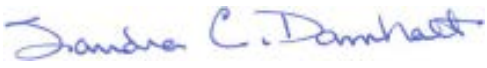

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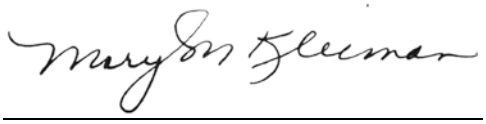

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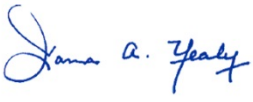

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