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June 12, 2023

Mr. Clinton Jones
General Counsel
Federal Housing Finance Agency
Eighth Floor, 400 Seventh Street, SW
Washington, D.C. 20219

Attention: Notice of Regulatory Review No. 2023–N–5

Dear Mr. Jones:

On behalf of the Federal Home Loan Banks actively participating in the Mortgage Partnership Finance® ("MPF ®") Program (each an "MPF Bank") and also the Federal Home Loan Bank of Cincinnati ("FHLB Cincinnati") that joins this comment as to issue numbers three and four below, the Federal Home Loan Bank of Chicago in its capacity as the MPF Provider respectfully submits this comment letter on the Federal Housing Finance Agency's (the "FHFA" or "Agency") Notice of Regulatory Review (the "Notice"). The Notice solicits comments on FHFA regulations (except for those regulations adopted or substantially amended within the past two years) for purposes of improving their effectiveness and reducing their burden. The Agency has invited feedback on whether there are better alternative methods that could be substantially more efficient to effect a regulatory or supervisory purpose. We believe that improvements in the areas described below would have a beneficial impact on the MPF Bank's and the FHLB Cincinnati's hard work in achieving its mission of providing liquidity to members and assisting members in furthering affordable homeownership in their local communities.

1. ***The Housing Goals Regulation (12 C.F.R. § 1281) should be amended to clarify the date on which the first housing plan could be required***

On June 25, 2020, the FHFA amended the Federal Home Loan Bank Housing Goals Regulation ("Housing Goals Rule"). The MPF Banks seek clarification of the 3 year implementation period. The housing plan provision of the rule provides: "…[f]or any year after 2023, if the Director determines that a Bank has failed to meet any housing goal and that the achievement of the housing goal was feasible, the Director may require the Bank to submit a housing plan for approval by the Director." *See* 12 C.F.R. § 1281.15. Regarding the implementation period, the supplemental information to the Housing Goals Rule provides: "the final rule establishes a three-year phase in period for enforcement of the two new housing goals, starting with the effective date of the final rule and ending on December 31, 2023. During the phase-in period, FHFA will monitor and report a Federal Home Loan Bank's housing goals performance but will not impose a housing plan remedy in the event that a Bank fails to meet either or both of the housing goal target levels." 85 F.R. 38031, 38033. We interpret the regulation to mean that the implementation period applies to a Federal Home Loan Bank's performance for the years 2021, 2022 and 2023, and that the FHFA will not impose a housing plan remedy for performance during those years. Therefore, we interpret the Housing Goals Rule to mean that the first year a housing

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plan remedy may be required would be based upon 2024 housing goals performance and we respectfully seek confirmation with our comment.

2. ***The Housing Goals Regulation (12 C.F.R. § 1281) should be amended to clarify that any consumer mortgage loan purchased can be counted towards housing goals achievement***

Acquired Member Assets ("AMA") loans purchased by a Federal Home Loan Bank are included within the purview of the Housing Goals Rule. The MPF Banks believe that allowing other consumer mortgage loans such as MPF Xtra loans to also qualify for credit under the Housing Goals Rule demonstrates a better alternative method to effect the regulatory purpose of the Housing Goals Rule which plays an important role in ensuring that Federal Home Loan Banks are purchasing loans made to low income borrowers, very low income borrowers, and borrowers in low income areas. When the FHFA originally created the Housing Goals Rule it did so pursuant to 12 U.S.C. § 1430c of the Federal Home Loan Bank Act where Congress directed the FHFA Director to "establish housing goals with respect to the purchase of mortgages, if any, by the Federal Home Loan Banks." 12 U.S.C. § 1430c(a). The Federal Home Loan Bank Act, however does not specify that the purchase of mortgages must be AMA, or that the loans must be held on a Federal Home Loan Bank's balance sheet in order to qualify for housing goals credit. We therefore propose that the Housing Goals Rule be clarified to provide credit to a Federal Home Loan Bank where its members sell consumer mortgage loans such as MPF Xtra loans under the MPF Program if the loans would otherwise qualify under the Housing Goals Rule if the loans were AMA. Federal Home Loan Banks should be provided credit for affordable housing loans purchased from its members even where the loans are not retained on a Federal Home Loan Bank's balance sheet as those loans may not have been originated but for the outlet provided under the MPF Program for MPF Xtra loans.

3. ***The Acquired Member Assets Regulation's (AMA Regulation's) Investment Grade definition (12 C.F.R. § 1268.1) that currently incorporates a materiality standard should be clarified so that credit enhancement shortfalls on certain loan pools where there is an absence of a safety and soundness concern are deemed compliant when evaluating a Bank's AMA portfolio***

The AMA Regulation (12 C.F.R.§ 1268) currently requires a member-provided credit enhancement on mortgage loan pools sold to a Federal Home Loan Bank such that the pools meet Investment Grade[1]. The definition of Investment Grade currently incorporates a materiality standard wherein a Bank must have a high degree of confidence that it will be repaid principal and interest on purchased loans in all material respects. The MPF Banks and FHLB Cincinnati ask the FHFA to clarify the definition of Investment Grade so that the current materiality standard is applied at the AMA portfolio level for a Bank in recognition that certain loan pools may exhibit a shortfall of credit enhancement even though members are providing credit enhancement. Banks purchase loans from members over a time period

[1] "*AMA Investment Grade* means a determination made by the Bank with respect to an asset or pool, based on documented analysis, including consideration of applicable insurance, credit enhancements, and other sources for repayment on the asset or pool, that the Bank has a high degree of confidence that it will be paid principal and interest in all material respects, even under reasonably likely adverse changes to expected economic conditions." 12 C.F.R. §1268.1.

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specified through contractual arrangements in order to provide liquidity to members as they originate loans in response to needs in their local communities. MPF Banks and FHLB Cincinnati have developed operational processes to determine the credit enhancement for loans purchased from members, however, these operational processes in some cases may result in a credit enhancement that falls short of Investment Grade due to matters outside the control of the Bank, such as market conditions negatively impacting anticipated volume, declines in housing prices, or minor differences in modeling results from third-party credit models used by a Bank during the contractual time period loans are purchased from a member.

When examining a Bank's AMA portfolio as a whole the amount of credit enhancement across the portfolio is sufficient and any shortfall on certain pools is immaterial as such shortfalls do not impact the safety and soundness of the Bank. Clarifying the definition of Investment Grade in recognition that credit enhancement shortfalls may occur does not detract from the purpose of the credit risk sharing requirement which is to encourage the delivery of high quality, well underwritten loans by a member to its Bank by requiring the member to retain a portion of the credit risk via the credit enhancement. Even where there is a credit enhancement shortfall, the member still provides credit enhancement on that particular pool of loans and any shortfall is immaterial when assessing a Bank's AMA portfolio. A Bank is in the best position and has the most incentive to ensure that the credit risk across its AMA portfolio is effectively managed. Therefore, the regulation should reflect that a credit enhancement shortfall on certain loan pools that does not pose a safety and soundness risk should not be considered a compliance concern and hence should be addressed in furtherance of the FHFA's request for feedback on ineffective or overly burdensome regulations. Such flexibility adds certainty to members selling loans to Banks who have come to rely on the loan products currently offered under the Mortgage Partnership Finance Program and the Mortgage Purchase Program.

4. ***The AMA Regulation (12 C.F.R. § 1268) should be amended to permit a Bank to design simplified product structures that allow a Bank to manage the credit risk on AMA loans as it deems appropriate in accordance with safety and soundness principles***

MPF Banks and the FHLB Cincinnati have expertise in managing credit risk on their investments in accordance with their risk tolerance and in a safe and sound manner. Requiring a credit risk sharing structure for AMA loans limits a Federal Home Loan Bank's ability to be creative in designing products or product enhancements to meet member and community needs. Also, the guidance[2] published in Advisory Bulletins and Supervisory Letters can also create a challenge for a Bank when it is determining its own risk appetite regarding the purchase of AMA loans. Currently, Banks are required to include a member-provided credit risk sharing component to AMA loan products. Under the AMA Regulation, the required credit enhancement can be achieved through funding the credit enhancement at loan purchase, requiring a contractual credit enhancement obligation and the purchase supplemental mortgage insurance as part of the credit enhancement structure. 12 C.F.R. § 1268.5. As mentioned earlier in this comment letter, the original purpose of requiring a member provided credit enhancement was to encourage the delivery of high quality, well underwritten loans through allocating a portion of the credit risk to the member who was in the best position to manage such risk. Since members have

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[2] Referenced guidance includes those articulated in Advisory Bulletins 2018-02 and 2020-01, and also DBR letters 2018-SYS164 and 2019-SYS-121.

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expertise in underwriting and also have knowledge of their local community, a portion of the credit risk was allocated to the member in the form of credit enhancement. However, the MPF Banks and the FHLB Cincinnati also have expertise to appropriately assess and manage credit risk. Hence, the MPF Banks and the FHLB Cincinnati would find value in the ability to develop new and innovative ways to manage the credit risk on AMA loans. For example, a Bank may choose to manage credit risk through allocating loan loss reserves perhaps in combination with the other currently permitted methods of meeting the credit risk sharing requirement.

Requiring a credit risk sharing structure under the AMA Regulation can be challenging for a Federal Home Loan Bank that would like to purchase more mission-focused loans because loans originated to lower income borrowers can have lower credit scores and down payments resulting in prohibitive credit enhancement requirements. A product structure that enables a Bank to appropriately manage the credit risk through a loan loss allocation for instance has the added benefit of being less risk based capital intensive for members which is a current impediment to loan deliveries for certain members we serve. Such a product structure would also provide the member with more available collateral to support increased advance activity for deployment in their local communities. Most importantly, the MPF Banks and the FHLB Cincinnati have other tools to ensure PFIs deliver high quality, well underwritten loans besides the reliance on credit risk sharing such as quality control, member oversight, contractual requirements concerning loan quality and consumer regulatory compliance, and the right to terminate a member's ability to sell loans to a Federal Home Loan Bank. The risk of being terminated from future deliveries and also having repurchase and indemnification exposure provide members with substantial incentive to deliver high quality, well underwritten loans. Accordingly, the MPF Banks and the FHLB Cincinnati respectfully request the FHFA to clarify in the AMA Regulation that a Federal Home Loan Bank is authorized to design AMA product structures that enable a Bank to manage the credit risk on AMA loans in accordance with its risk tolerance and in a safe and sound manner.

Thank you for your consideration of these comments.

Sincerely,

Federal Home Loan Bank of Chicago
in its role as MPF Provider

John Stocchetti
Executive Vice President,
MPF Program Executive

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