FHLBANKS
A NATION OF LOCAL LENDERS

June 13, 2023

Mr. Clinton Jones
General Counsel
Attention: Comments/Regulatory Review No. 2023-N-5
Federal Housing Finance Agency
Eighth Floor, 400 Seventh Street, SW
Washington, D.C. 20219

Dear Mr. Jones:

On behalf of the Council of Federal Home Loan Banks (the "Council"), and with the unanimous support of the 11 Federal Home Loan Banks (each an "FHLBank") and the Office of Finance (the "OF" and, collectively with the FHLBanks, the "FHLBank System"), I appreciate this opportunity to comment on the Federal Housing Finance Agency's (the "FHFA") Notice of Regulatory Review (the "Notice"). The Council is a trade association that represents the FHLBank System's views and positions before policymakers.

The Notice solicits comments on FHFA regulations, except for those regulations adopted or substantially amended within the past two years, "for the purpose of improving their effectiveness and reducing their burden."

This letter identifies the regulatory issues the FHLBank System considers most in need of review and revision. This letter is divided into two parts. The first part summarizes new comments on FHFA regulations since 2018, the last time the FHFA requested comments on its regulations. The second part highlights certain issues identified in the 2018 FHFA regulatory review that have not yet been addressed.

I. New 2023 FHFA Regulatory Review Cycle

FHFA Should Revise the Material Contract Clause in 12 C.F.R. § 1223.21(b)(9)

The Office of Minority and Women Inclusion ("OMWI") regulations require that each FHLBank and the OF include a "material contract clause" ("MCC") in each contract for goods valued at over $25,000 per year and each contract for services, regardless of spend, that it enters into "committing the contractor to practice the principles of equal employment opportunity and non-discrimination in all its business activities and requiring each such contractor to include the clause in each subcontract it enters for services or goods provided to the regulated entity."[1]

[1] 12 C.F.R. §§ 1223.3(b), 1223.21.

Further, the FHLBanks and the OF find value in asking some third parties to include such a commitment in their contracts. In addition, we note that federal law also prohibits discrimination in hiring and the workplace.

Nevertheless, we request that the FHFA expand its limitations or introduce certain exclusions from the MCC under 12 C.F.R. § 1223.3(b), because the current requirement is overly burdensome and redundant, conflicts with other laws in the United States, and does not create meaningful contract terms that an FHLBank and the OF can enforce. Indeed, Section 1116 of Pub. L. 110-289, the Housing and Economic Recovery Act of 2008 ("HERA"), the legislation implemented by the OMWI regulations, does not contemplate a material contracts clause at all. Instead, the OMWI regulations state, "*[A]s a matter of public policy* FHFA believes that any regulated entity or the Office of Finance, as a Federal government sponsored enterprise, should decline to enter into business with contractors who find such clauses objectionable."[2] As the MCC requirement is a matter of policy, the FHFA has the ability to modify this requirement.

We suggest that the FHFA add exclusions to the MCC requirement for certain types of contracts that are difficult to negotiate. The FHLBanks and the OF often do not have the "purchasing power" to force third parties to the negotiation table. Contracts that have "click to agree" terms, such as software licenses or maintenance contracts, contracts with single-source providers, and contracts where the terms are established or maintained by a regulatory body, such as insurance policies and General Services Administration schedules, should be excluded from the MCC requirement.

In addition, we request that the FHFA eliminate the requirement in the regulation that the MCC be inserted into all services contracts and all contracts for goods with at least $25,000 in annual spend, because, despite the name "materiality clause" in the regulation, failure to abide by the MCC does not amount to a material breach of the contract. The MCC is not the defining purpose of any of the FHLBanks' or the OF's third-party contracts. Therefore, the FHLBanks and the OF have limited enforcement mechanisms for bringing a breach claim against a third party that does not abide by the contractual commitment to practice the principles of equal employment opportunity and non-discrimination. Likewise, the FHLBanks and the OF do not have a strong enforcement case for contractually obligating third parties to insert such a clause in all subcontracts. This is particularly evident in cases where third parties already have agreements in place with the intended subcontractors.

Alternatively, the FHFA could allow third parties to demonstrate to the FHLBanks and the OF their commitment to equal employment opportunity and non-discrimination through non-contractual means. Many third parties abide by the principles of equal employment opportunity and non-discrimination without a contractual obligation. The regulation should allow the FHLBanks and the OF to confirm third parties' commitments to these principles through non-contractual means, such as the third parties' policies and procedures, legal and regulatory obligations, or other evidence of their compliance in this area.

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[2] Minority Women and Inclusion, 75 Fed. Reg. 81,395, 81,399 (Dec. 28, 2010) (emphasis added). The OMWI regulations also state that Executive Order 11246 requires similar contractual language in government contracts, as it has done so for 40 years.

FHFA Should Clarify the Role of Supervisory Guidance

The primary banking regulators, the Office of the Comptroller of the Currency (the "OCC"), the Board of Governors of the Federal Reserve System (the "Federal Reserve"), the Federal Deposit Insurance Corporation ("FDIC"), the National Credit Union Administration, and the Consumer Financial Protection Bureau, have all adopted the September 11, 2018 Interagency Statement Clarifying the Role of Supervisory Guidance.[3] We believe the FHFA should, for the reasons articulated in the OCC's final rulemaking, namely, to provide clarity to institutions and supervisory staff to ensure a consistent approach, adopt a similar statement in its own regulations.[4] Further, the Council recommends that, going forward, the FHFA give due consideration as to whether a regulatory topic is more appropriately addressed in the form of regulation or guidance. In many cases, regulations are more appropriate than guidance. 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 helps to create and sustain a system of rulemaking that is ultimately beneficial for the FHLBank System and its dual mission providing liquidity to members and supporting housing and community development. The FHFA's recent review of the FHLBank System, *FHLBank System at 100: Focusing on the Future*, reflects the value of implementing such an approach. As an integral part of this review, the FHFA placed an emphasis on gathering input from a variety of stakeholders, including the FHLBank System, members, affordable housing project sponsors, and the public. We believe this approach, which includes seeking, gathering, and analyzing input from a variety of stakeholders, should continue to be applicable to FHFA regulatory action following the completion of the FHLBank System review, as those same stakeholders may continue to have an interest in FHFA actions that affect the FHLBanks, the OF, FHLBank members, and other FHLBank System stakeholders.

FHFA Should Streamline Conflict of Interest Regulations Between Directors and AHP Advisory Council

FHFA regulations contain two sets of conflict of interest recusal rules that apply to the FHLBanks: 12 C.F.R. § 1261.11(b), pertaining to FHLBank directors on all matters coming before an FHLBank's board, and 12 C.F.R. § 1291.16, pertaining to FHLBank directors, employees, and Advisory Council members called to make determinations relating to Affordable Housing Program ("AHP") applications and projects.

Both regulations prescribe the same remedy – recusal – where a conflict arises. But the standards for what constitutes a conflict are inconsistent between the two regulations. We believe that there are opportunities to modernize and clarify the conflict standards.

To address these concerns in 12 C.F.R. § 1261.11(b), we recommend amending the existing definition of "financial interest" under § 1261.11(f)(2), which excludes ordinary course deposit or savings accounts maintained with a member and ordinary course loans or extensions of credit obtained from a member. The premise – that receiving customary financial services products on

[3] Interagency Statement Clarifying the Role of Supervisory Guidance (Sept. 11, 2018), https://www.fdic.gov/news/press-releases/2018/pr18059a.pdf.

[4] Role of Supervisory Guidance, 86 Fed. Reg. 9,253 (Feb. 12, 2021).

non-preferential terms does not create a conflict for a director – is correct. However, the definition does not go far enough to apply the underlying principle to certain other accounts and products that are obtained under similar circumstances. We recommend the definition be amended to also exempt insurance accounts and products obtained in the normal course of business on terms that are generally available to the public, exempt securities accounts, and products obtained in the normal course of business on terms that are generally available to the public, as well as shares in investment funds where the director does not have the ability to manage the underlying investments, such as mutual funds and exchange traded funds, and clarify that all of the indicated financial products (*i.e.*, deposit/savings accounts, loans/extensions of credit, insurance accounts/products, and securities accounts/products) are exempt, whether the director obtains them from a member institution or from a non-member counterparty to the director's FHLBank.

To address these concerns in the AHP conflict regulation, we recommend harmonizing the standard for what constitutes a conflict in that regulation with the relevant standard for FHLBank directors. For example, 12 C.F.R. § 1291.16 currently has no definition of "financial interest." One should be added, and it should be identical to the definition of "financial interest" in the director conflict of interest regulations (12 C.F.R. § 1261.11(f)(2)) and be subject to the same exemptions. In addition, 12 C.F.R. § 1291.16 currently uses a definition of "family member" that makes it impossible to determine its scope, as arguably "any individual related to a person by blood, marriage, or adoption" includes many distant relatives unknown to the person making decisions for an FHLBank. The regulation should be revised to instead use "immediate family member" as defined in the director conflict regulations (12 C.F.R. § 1261.11(f)(1)).

FHFA Should Reform the Suspended Counterparty Program Reporting Requirements

The FHFA should clarify the definition of "Covered Misconduct" under 12 C.F.R. §1227.2 to specify that it is not the FHFA's intent that the FHLBanks submit reports where a conviction is based on fraud that occurs in connection with "other lending product[s]" unrelated to mortgages. We recommend that the FHFA adopt the following definition of "covered misconduct":

> "Any conviction or administrative sanction within the past three (3) years if the basis of such action involved fraud, embezzlement, theft, conversion, forgery, bribery, perjury, making false statements or claims, tax evasion, obstruction of justice, or any similar offense, in each case in connection with a mortgage, mortgage business, mortgage securities or other *mortgage – related* lending product." [suggested edit italicized for emphasis].

The incorporation of this definition into 12 C.F.R § 1227.2 will reduce the ambiguity in the regulation and promote consistent reporting among the FHLBanks.

In addition, we recommend that the FHFA specify within the regulation that reports should only be submitted for convictions originating within the jurisdiction of the United States of America and its territories. Not only does this align with the FHFA's previously stated position that "FHFA intends the definition of conviction to encompass both state and federal courts,"[5] but it

[5] Suspended Counterparty Program, 80 Fed. Reg. 79,675, 79,678 (Dec. 23, 2015).

also avoids differing thresholds and definitions of fraud and financial misconduct that non-U.S. jurisdictions may have.

We also recommend that the FHFA consider revising the definition of "Affiliate" under 12 C.F.R. §1227.2 to more closely align with entities to which the FHLBanks have a direct nexus. For example, due to the organizational structure of some of the FHLBank's counterparties, the FHLBanks may have a contract or other "covered transaction" with an entity that is under the same common control as a convicted entity through a parent company. Although the FHLBanks may not have a direct relationship to the convicted entity, the current definition of "Affiliate" and the application of 12 C.F.R. § 1227.4 can be read to require the FHLBanks to submit a report on an entity that has no affiliation with the FHLBanks other than a common parent company. Such reports are not directly related to the underlying goal of the suspended counterparty program to "address the risk to the regulated entities presented by individuals and entities with a history of fraud or other financial misconduct."[6]

FHFA Should Reform the Standardized Minimum Initial Margin Requirements for Non-cleared Swaps and Non-cleared Security-based Swaps in 12 C.F.R. § 1221, Appendix A

We recommend that the FHFA, in coordination with the other Prudential Banking Regulators implementing the Margin and Capital Requirements for Covered Swap Entities regulation (the OCC, the Federal Reserve, the FDIC, and the Farm Credit Administration), amend the definition of Net-to-Gross Ratio ("NGR") in footnote 1 of Appendix A to 12 C.F.R. §1221 to remove the following adjustment: "In cases where the gross replacement cost is zero, the NGR should be set to 1.0."

Application of this adjustment to the calculation, when required by the regulation, can result in significant movement in the Potential Future Exposure ("PFE") calculation. For example, if all of the trades with a particular counterparty are in an out-of-the-money position, the PFE increases by 2.5 times. However, if one trade moves position and comes into the money, the PFE will decline by 2.5 times. The result is significantly increased PFE volatility. If the FHFA removes the language in question such that the NGR remains at zero when the gross replacement cost is zero, the resulting PFE calculation can accommodate a position move with comparative stability. We would also like to recommend that the FHFA clarify the intended purpose of the above-referenced adjustment.

FHFA Should Clarify the Scope, Form, and Content of Combined Financial Reports under 12 C.F.R. § 1273.6(b)(1)

12 C.F.R. § 1273.6(b)(1), related to the requirements for the Combined Financial Reports ("CFRs") of the FHLBank System, states that "[the] scope, form, and content of the disclosure generally shall be consistent with the requirements of the Securities and Exchange Commission Regulations S-K and S-X (17 C.F.R. parts 229 and 210)." As Regulations S-K and S-X outline qualitative and quantitative disclosure requirements for a broad range of filings by SEC registrants, including those under the Securities Act of 1933 and the Securities Exchange

[6] *Suspended Counterparty Program*, FED. HOUS. FIN. AGENCY, https://www.fhfa.gov/SupervisionRegulation/LegalDocuments/Pages/SuspendedCounterpartyProgram.aspx (accessed May 10, 2023).

Act of 1934, as amended, many items under those regulations do not apply to the filing of periodic reports, such as Forms 10-K and 10-Q generally (*e.g.*, items under subpart 229.500 relating to registration statement and prospectus), or to the filing of Forms 10-K and 10-Q by the FHLBanks. Rather, Forms 10-K and 10-Q reference specific items under Regulations S-K and S-X within the scope of those forms and instruct SEC registrants to furnish information that is responsive to those specified items, to the extent applicable. We believe that it is appropriate to clarify the provisions under 12 C.F.R. § 1273.6(b)(1) to the following effect:

> "The scope, form, and content of the disclosure generally shall be consistent with the requirements of the Securities and Exchange Commission Regulations S-K and S-X (17 C.F.R. parts 229 and 210) as applicable to the corresponding annual or quarterly reports of the Banks filed with the Securities and Exchange Commission."

We believe that such clarification would be consistent with the intent under 12 C.F.R. § 1273.6(b)(1) in the context of the preparation of the CFRs (which are intended to combine relevant disclosures made by the FHLBanks in their annual or quarterly reports for a given period) so as not to give the impression that the CFR disclosure is required to generally comply with all of the items set forth under Regulations S-K and S-X, whether or not these items are relevant to Forms 10-K and 10-Q or to the FHLBanks.

In addition, 12 C.F.R. § 1273.6(b)(3) states that "[the] standards set forth in paragraphs (b)(1) and (b)(2) of this section are subject to the exceptions set forth in Appendix A to this part." We recommend that the FHFA review the list of exceptions set forth in Appendix A against Regulations S-K and S-X from time to time, as these regulations have evolved since the initial adoption of 12 C.F.R. § 1273 in 2010 and continue to evolve, and consider whether it is appropriate to potentially expand the exceptions set forth in Appendix A and streamline the CFR disclosure in light of its purpose and audience. For example, it may be worth considering whether it is appropriate to further simplify and streamline the scope of required compensation disclosure under Item 402 of Regulation S-K in the CFRs, guided by materiality considerations, as a key audience of the CFRs is investors in the consolidated obligations of the FHLBanks (as opposed to, for example, shareholders of the FHLBanks).

FHFA Should Clarify the Deadline for Filing and Distribution and Incorporate the "Access Equals Delivery Model" under 12 C.F.R. § 1273.6(b)(4)

12 C.F.R. § 1273.6(b)(4), related to the filing and distribution of the CFRs, states that:

> "[the] combined Bank System annual financial reports shall be filed with FHFA and distributed to each Bank and Bank member within 90 days after the end of the fiscal year. The combined Bank System quarterly financial reports shall be filed with FHFA and distributed to each Bank and Bank member within 45 days after the end of the of the first three fiscal quarters of each year."

We recommend that this section be revised to explicitly account for the specified deadline falling on a weekend or a public holiday, to the effect that, if such a due date falls on a Saturday, Sunday, or public holiday, the CFR would be due on the following business day. We believe this

would be consistent with how filing deadlines are treated by the Securities and Exchange Commission ("SEC") (*e.g.*, 17 C.F.R. §§ 240.0-3) and by the FHFA under its rules of practice and procedure (*e.g.*, 12 C.F.R. § 1209.17).

Furthermore, with respect to the requirement that the CFRs be filed with the FHFA and distributed to each FHLBank and FHLBank member, we recommend that the principle under the SEC's "access equals delivery" model be incorporated. The SEC adopted an "access equals delivery" model for delivery of final prospectuses in 2005, for example, based on the assumption that investors have access to the Internet, thereby permitting issuers and intermediaries to satisfy their delivery requirements if those documents are posted on a designated website. Since then, the SEC has applied the "access equals delivery" model to other situations, noting that the expanded use of the Internet and continuing technological developments suggested that these delivery requirements be updated in a manner that is consistent with that model. Although the CFRs are not filed with the SEC, over the years, a well-established practice has developed for the OF to post and make available the CFRs on the OF's public website upon publication. We believe that such website posting would provide the FHLBanks and their members and investors in consolidated obligations with timely, convenient, and adequate access to the CFRs and improve operational efficiency (particularly in light of the total number of FHLBank members, approximately 6,500 currently, involved for this purpose). Therefore, we recommend that the FHFA remove the filing and distribution requirement from this section or provide that the filing and distribution requirement would be deemed satisfied if the CFRs are posted and made available on the OF's public website (or another designated website accessible to the public) by the applicable deadline.

FHFA Should Modify the In-person Meeting and Contract Review/Approval Requirements under 12 C.F.R. § 1273.8

12 C.F.R. § 1273.8(b), related to the conduct of meetings of the board of directors of the OF, states that "[the] OF board of directors shall conduct its business by majority vote of its members at meetings convened in accordance with its by-laws, and shall hold no fewer than six in-person meetings annually." We believe that the advancement of video conferencing and other technology, as well as the recent experience gained through conducting board of directors meetings remotely during the period of time when in-person meetings were restricted due to the COVID-19 pandemic, have demonstrated that meetings of the board of directors could be conducted effectively and efficiently without the need to meet in person each time. Furthermore, the six in-person meeting requirement may inadvertently limit the pool of talented and qualified candidates who may otherwise be interested in serving as independent directors of the board. We recommend that the six in-person meeting requirement be eliminated and that this section be revised to permit the board of directors to conduct meetings in a manner as specified in its by-laws or as otherwise determined by the board of directors consistent with its fiduciary duties. We appreciate the FHFA's accommodations in this regard provided to us through related waivers during the pandemic and the FHFA staff's willingness to consider possibly revising or clarifying this requirement in light of the greater prevalence of remote work during and after the pandemic.

In addition, 12 C.F.R. § 1273.8(d)(4), related to the board of directors' duties, states that the OF board of directors shall "[review] and approve all contracts of the OF, except for contracts for which exclusive authority is provided to the Audit Committee by paragraphs (b)(5) and (b)(6)

of § 1273.9." We believe that contract review and approval, other than those contracts for which exclusive authority is provided to the Audit Committee (which is addressed separately in related regulations governing the Audit Committee), generally falls under management's responsibilities. The board of directors will exercise its oversight responsibilities, as appropriate, but specifying that it shall review and approve all contracts appears neither practical nor necessary. We recommend that this section be removed so that the related practices can be more aligned with those at other entities regulated by the FHFA and other organizations.

FHFA Should Eliminate the OF's Monitoring of the FHLBanks' Unsecured Credit Exposure under 12 C.F.R. § 1273.6(f)

12 C.F.R. § 1273.6(f), related to the monitoring of the FHLBanks' unsecured credit exposure, states that the OF shall "timely monitor, and compile relevant data on, each FHLBank's and the FHLBank System's unsecured credit exposure to individual counterparties." We note that, under 12 C.F.R. § 1277.7, the FHLBanks are required to comply with regulatory limits on unsecured extension of credit and report information relating to their credit exposure to the FHFA. Since 2015, under the new reporting process developed by the FHFA, the FHLBanks have submitted unsecured credit exposure information required under these regulations directly to the FHFA instead of reporting it through the OF, as before. In light of these process changes (including the change in the OF's role in the related data collection and compilation process), the existence of a separate regulatory mechanism (independent of the OF) under which the FHLBanks monitor and report on their unsecured credit exposure and the lack of day-to-day involvement by the OF in the FHLBanks' extension of unsecured credit to their counterparties, we believe that the requirement on the OF under 12 C.F.R. §1273.6(f) is duplicative, burdensome, and obsolete.

We note that, to the extent any unsecured credit exposure information relating to any FHLBank is significant enough for disclosure in the CFRs, that information will be collected, compiled, and reported on under generally accepted accounting principles or pursuant to other disclosure requirements, as in the cases of other relevant items, in the ordinary course of the preparation of the CFRs. 12 C.F.R. § 1273.6(f) would be unnecessary for that purpose, as CFR disclosures are already governed by existing FHFA regulations.

FHFA Should Modernize the Transfers of the OF Operating Funds under 12 C.F.R. § 1273.5(b)(1)(ii)

12 C.F.R. § 1273.5(b)(1)(ii), related to the funding of the OF, states that the OF operating funds shall be "[subject] to withdrawal by check, wire transfer or draft signed by the Chief Executive Officer or other persons designated by the OF board of directors." We recommend that this regulation be modernized so as to explicitly permit the use of other widely accepted fund transfer methods, particularly electronic fund transfer methods, that have been developed (such as ACH) or may be developed in the future. In addition, in light of the practical needs for operational efficiency (*e.g.*, payroll disbursements, vendor payments, and other ordinary course fund transfers), we recommend that this regulation be clarified to explicitly allow for persons designated by the Chief Executive Officer (or otherwise authorized in accordance with the OF's governance documents) to authorize withdrawals or other fund transfers.

FHFA Should Clarify the Records Retention Regulations under 12 C.F.R. § 1235.3

12 C.F.R. § 1235.3 of the records management regulations requires each FHLBank and the OF to submit to the FHFA a copy of their respective written record retention programs on an annual basis and an evaluation of program adequacy on a biennial basis. We recommend that the agency clarify whether there are common deadlines that apply to all FHLBanks and the OF for the annual and biennial submissions and, if there are common deadlines, specify the deadlines in the regulation. Further, we recommend that the FHFA assess whether it utilizes these records and, if not, eliminate or consolidate the reporting requirements.

FHFA Should Coordinate New Reporting Obligations on the FHLBank System

We recommend that the FHFA assess all of its required reporting regulations to determine whether each report remains necessary or is duplicative of other reports provided by the FHLBanks. Based on this assessment, the FHFA should eliminate reporting requirements with respect to reports that are no longer used by the FHFA or are duplicative of other reporting requirements. In particular, the FHFA has three reporting requirements (the Affordable Housing Advisory Council ("AHAC") Report, the OMWI Report, and a revamped Mission Report) that could be better coordinated. The new Mission Report's data fields could be better aligned to data fields required for the OMWI report and AHAC report. Improving the data collection process for these reports would reduce redundancies and costs and provide for more comprehensive reports.

As the FHFA contemplates new reporting obligations on the FHLBank System, the FHFA also should carefully coordinate such new reports with existing reporting obligations to streamline reporting obligations, avoid duplicative reports, and minimize the costs associated with producing the reports.

FHFA Should Consider "Housing Reserve-Related Assets" as Eligible Mortgage-Related Assets under 12 C.F.R. § 1263.6(c)

12 C.F.R. § 1263.6(c) requires that insurance companies and other non-depositories "have mortgage-related assets that reflect a commitment to housing finance, as determined by the FHLB[ank] in its discretion." The term "mortgage-related assets" has not been defined since the inception of this membership eligibility criterion. Indeed, in its final rule amending FHLBank membership to include community development financial institutions ("CDFIs"), the FHFA explicitly states "[t]he term 'mortgage-related assets' is not defined, and FHFA believes that the term can be construed broadly."[7] We recommend that the FHFA recognize that housing-related insurance products offered by insurance companies enable borrowers to purchase and stay in their homes. Therefore, consistent with a broad reading of the term "mortgage-related asset," it would be well within the meaning of 12 C.F.R. 1263.6(c) for FHLBanks to consider certain insurance company applicants' "Housing Reserve-Related Assets (defined below)" in their analyses of whether, in their discretion, the applicants sufficiently demonstrate a commitment to housing finance.

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[7] Federal Home Loan Bank Membership for Community Development Financial Institutions, 75 Fed. Reg. 678, 683 (Jan. 5, 2010).

Housing Related Insurance Companies (certain insurance company applicants whose lines of business include housing-related insurance, such as homeowners or mortgage guaranty or title insurance companies) offer products that are essential, and in many cases required by lenders, in order for borrowers to purchase single-family or multifamily properties and to execute and maintain mortgage contracts. Because these insurance products are required to obtain a mortgage, Housing Related Insurance Companies are vital to housing finance. Generally, an insurance company is required to hold loss reserves in an amount that reflects the insurer's estimates of outstanding losses, loss of adjustment expenses, and other related items. In order to meet their obligations associated with their loss reserves, insurance companies invest in assets pursuant to their statutory investment authority, as well as their internal investment policies.

The "Housing Reserve-Related Assets" are the amount of statutory assets required to support the statutory loss reserves arising from housing-related insurance policies written by the insurer. While many insurance companies are able to invest in Mortgage-Related Assets, Housing Related Insurance Companies, through corporate governance or statute, may be subject to investment restrictions on mortgage-related assets in order to achieve diversification of their overall risk since their liabilities are already housing- and/or mortgage-related. The National Association of Insurance Commissioners ("NAIC"), in its Accounting Practices and Procedures Manual, has gone further in its guidance, explicitly restricting mortgage guaranty insurers from mortgage investments:

> Investment Limitation
>
> 4. A mortgage guaranty insurance company shall not report as an admitted asset notes or other evidences of indebtedness secured by mortgage or other lien upon real property. This provision shall not apply to obligations secured by real property, or contracts for the sale of real property, which obligations or contracts of sale are acquired in the course of the good faith settlement of claims under policies of insurance issued by the mortgage guaranty insurance company, or in the good faith disposition of real property so acquired.

States often enact the NAIC guidance either explicitly or by reference. For example, Wisconsin adopted the NAIC language (with a few minor, non-substantive changes). By virtue of their housing- and mortgage-related liabilities, Housing Related Insurance Companies may, by statute or internal policy, act to manage their risk by avoiding or limiting their investment in Mortgage-Related Assets.

By offering insurance products that are critical to housing finance and the mortgage market, Housing Related Insurance Companies clearly demonstrate their commitment to housing finance. By looking to the amount of an insurer's Housing Reserve-Related Assets, FHLBanks are able to quantify an insurer's commitment to housing finance that may not be otherwise reflected in their asset composition.

FHFA Should Allow CDFIs to Meet Either a Mortgage-Related Asset Test Demonstrating a Commitment to Housing Finance or, Alternatively, a Community Lending-Based Evaluation for Membership Eligibility under 12 C.F.R. § 1263.6(c)

In 2010, when CDFIs were authorized by Congress to become members in the FHLBank System, the FHFA issued membership eligibility requirements for these new members. In its final rule, the FHFA required that CDFI applicants that were not insured depository institutions meet the alternative "mortgage-related assets" test. In the final rule, the FHFA noted that:

> [t]he term "mortgage-related assets" is not defined, and FHFA believes that the term can be construed broadly in considering whether a CDFI applicant meets this requirement. Moreover, the regulations do not require that a CDFI applicant's assets be exclusively, or even predominantly, oriented to traditional housing finance. What is required is that the CDFI applicant has assets that, when viewed in the overall context of the applicant's business and how it provides products and services to its targeted markets, can be fairly said to support housing finance. Because CDFI applicants are apt to have asset profiles that differ from those that the [FHLBs] typically review, the FHFA expects that the [FHLBs] will consider the assets of CDFI applicants in light of their unique mission. Thus, although a CDFI may be able to demonstrate its commitment to housing finance through traditional means, such as by originating mortgage loans or otherwise to supporting the development or acquisition of housing, it also may demonstrate its commitment through other means. Examples of such other means would include, but are not limited to, loans related to manufactured housing (regardless of whether the unit is deemed to be real estate), pre-development or construction loans for real estate that will become or include residential property, or loans secured by subordinated liens on residential real estate.[8]

The FHFA recognized the importance of applying a broad view in determining whether a CDFI sufficiently demonstrates a commitment to housing finance through either "traditional means" or "other means." While this rationale may enable certain CDFI applicants to qualify for FHLBank membership by demonstrating a commitment to housing finance, it fails to account for and excludes from membership consideration those CDFI entities that concentrate in the other core tenet of the FHLBank System's mission, which is community lending. 12 C.F.R. § 1265.2 states:

> "The mission of the Banks is to provide to their members' and housing associates financial products and services, including but not limited to advances, that assist and enhance such members' and housing associates financing:
>
> (a) Financing of housing, including single-family and multi-family housing serving consumers at all income levels; and
>
> (b) Community lending."

Under the current regulatory membership eligibility criteria, there is no consideration or credit given to those CDFIs that may not hold substantial mortgage-related assets but that are otherwise meaningfully engaged in community lending and economic development. Any membership eligibility criteria should give due attention to the importance of a non-depository's community

[8] *Id.*

lending activities, as it directly aligns with and supports the community lending mission of the FHLBanks.

FHFA Should Conduct Rulemaking on FHLBank Officer Conflicts of Interest to Clarify FHFA Recommended Practices

While there are no regulations or guidance on the topic, the FHFA has taken the position that, for the appearance of conflict reasons, an FHLBank officer cannot serve as a director on the board of a member institution of another FHLBank. This is the case even when the member has no contacts with the FHLBank with which the officer is affiliated.

These informal determinations, not based on regulation, contradict another FHLBank practice of generally encouraging board service by FHLBank staff and officers to support nonprofit housing initiatives and sponsor capacity building, as well as participation on federal- or state-created boards addressing important public matters. In those cases, FHLBank officers have ably served on those boards, and, if conflicts arose (including from applications for Affordable Housing grants from the officers' FHLBanks), the officers effectively used disclosure and recusal requirements established under the corporate governance laws and internal policies and procedures to address conflict issues. Given these inconsistencies, we request that the FHFA address FHLBank officer board service in a comprehensive rulemaking.

II. Outstanding Issues from the 2018 FHFA Regulatory Review

The following issues were raised during the FHFA's 2018 regulatory review and remain outstanding in 2023:

- *Municipal Securities as Eligible Collateral – 12 C.F.R. § 1266.7(a)(4)*: We recommend that the FHFA 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 under 12 C.F.R. § 1266.7(a)(4).

- *Redefine "Advances" for Purposes of the Independent Director Regulations to Specifically Exclude Housing Finance Agency ("HFA") Bonds*: Neither the FHFA's Independent Director Forms nor the Director Regulations define the scope of "advances" for purposes of conflicts of interest. Consequently, this term could be interpreted to include other transactions between FHLBanks and HFAs, such as FHLBank purchases of HFA general obligation bonds. The FHFA's existing general regulatory definitions limit "advances" to secured transactions. However, if the FHFA interprets "advances" more broadly for purposes of Independent Director conflicts of interest to include HFA Bonds, 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 Bonds. Taking this approach would frustrate a core mission of the FHLBanks to support affordable housing in their respective districts.

- *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." 12 C.F.R. § 1263.7 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." The word "chartered" suggests a charter granted by a regulatory authority (such as a bank charter granted by a state banking commissioner or the OCC), and the word "incorporated" suggests organization through filing articles of incorporation with a state's secretary of state. By using these words, the FHFA's regulation unnecessarily suggests a narrower approach than permitted by the statutory "duly organized" language. We recommend that the FHFA update its language to clarify this point.

- *Financial Condition Requirement for… Certain CDFI Applicants – 12 C.F.R. § 1263.16*: We recommend that the FHFA clarify 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 recommend that this section be revised to allow for an FHLBank to determine the appropriate underwriting criteria when evaluating whether a CDFI is financially strong and that advances can be safely made to the CDFI.

Thank you for your consideration of these comments.

Sincerely,

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Ryan Donovan
President and Chief Executive Officer
Council of Federal Home Loan Banks