NATIONAL ASSOCIATION
OF HOME BUILDERS

REGULATORY & HOUSING POLICY AREA

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Federal Housing Finance Board
1625 Eye Street, NW
Washington, D.C. 20006
Attention: Public Comments

Re: Federal Housing Finance Board Proposed Rule:
Excess Stock Restrictions and Retained Earnings
Requirements for the Federal Home Loan Banks
RIN Number 3069-AB30
Docket Number 2006-03

Dear Sir or Madam:

On behalf of the 225,000 member firms of the National Association of Home Builders (NAHB), I am responding to your request for comments on the Federal Housing Finance Board's (Finance Board) proposal to establish excess stock restrictions and retained earnings requirements for the Federal Home Loan Banks (FHLBanks).

NAHB is a national trade association representing individuals and companies involved in the production of housing and related activities. Each year, NAHB's builder members construct about 80 percent of all new housing in America. NAHB's builder members are mostly small businesses that depend almost entirely on federally insured depository institutions for housing production credit. Our surveys show that more than 90 percent of all loans for residential land acquisition, development and construction (AD&C) come from commercial banks and thrifts, most of which rely significantly on the FHLBank System as a source of liquidity. These banks and thrifts also utilize FHLBank programs and resources to address housing and community development needs in their districts. Therefore, NAHB views the FHLBanks as crucial components of the housing finance system.

Background

The proposal would limit the amount of excess stock that a FHLBank can have outstanding and would prescribe a minimum amount of retained earnings for each FHLBank. The proposal also would prohibit a FHLBank from selling excess stock or paying stock dividends to its members, and would restrict a FHLBank's ability to pay dividends when its retained earnings are below the prescribed minimum. The limit on the amount of excess stock

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outstanding would be set at one percent of a FHLBank's total assets. The minimum requirement for a FHLBank's retained earnings would be $50 million plus one percent of the FHLBank's non-advance assets. A FHLBank not meeting the retained earnings minimum would not be permitted to pay dividends in excess of 50 percent of its net earnings without prior approval from the Finance Board.

The Finance Board states that these changes are being proposed for prudential reasons to address its concerns that some FHLBanks increasingly use excess stock to capitalize assets that are long term in nature and not readily saleable, or that are not mission related. The Finance Board believes that undue reliance on excess stock by a FHLBank to meet minimum capital requirements and to capitalize its balance sheet activities raises both safety and soundness and public policy issues.

The Finance Board is also concerned that the FHLBanks' current levels of retained earnings are not adequate to protect against potential impairment of the par value of the FHLBanks' capital stock, which the Finance Board believes is key to the stability of the Federal Home Loan Bank System. The proposed rule is intended to help ensure that each FHLBank's level of retained earnings adequately reflects its risk profile and that there is greater consistency among the FHLBanks' retained earnings policies. The aim of establishing a retained earnings minimum is to increase the proportion of FHLBank capital accounted for by retained earnings.

NAHB Position

NAHB strongly opposes the proposal. NAHB firmly believes the FHLBanks should be adequately capitalized and should operate in a safe and sound manner, and we fully support the role of the Federal Housing Finance Board in ensuring such results. However, NAHB does not feel that the proposal on excess stock restrictions and retained earnings requirements is an appropriate means of regulating the capital adequacy of the FHLBanks and we are concerned that implementation of the proposal could have the unintended consequences of harming the financial condition of the FHLBanks and impairing their capacity to serve their housing and community development mission.

One-Size-Fits-All-Approach

The proposal takes an oversimplified, one-size-fits-all approach that fails to recognize the considerable fiscal and operational differences among the individual FHLBanks. The characteristics of member institutions and housing and community development needs vary markedly from district to district and each of the FHLBanks has adapted their organizations to provide products and services in a form and manner to address those needs. NAHB does not believe it is appropriate to apply a homogenized formula to 12 unique institutions.

The Finance Board makes it clear that it will continue to assess the retained earnings positions of the individual FHLBanks, as is its responsibility in regulating the safety and soundness of the System. The preamble to the proposed rule states that there may be a need to address specific problems or events at individual FHLBanks by requiring a FHLBank to hold levels of retained earnings that would be higher than that calculated under the formula, if warranted for safety and soundness reasons. It is also reasonable to expect that specific circumstances at individual FLHBanks may merit lower levels of retained earnings than would be dictated by the proposed formula. NAHB, therefore, concludes that regulatory oversight of FHLBank retained earnings levels should be conducted on a case-by-case basis rather than based on a monolithic formula.

Gramm-Leach-Bliley Act Capital Requirements

Another problem with the proposal is that it is being promulgated outside, and could possibly conflict with, the FHLBank capital regulations that were established previously by the Finance Board to implement the requirements of the Gramm-Leach-Bliley Act (GLBA). The Finance Board has approved the capital plans for eleven of the twelve FHLBanks that were submitted in compliance with the GLBA capital regulations and that contained specific policies on excess stock and retained earnings. NAHB believes that the Finance Board's regulatory actions on excess stock and retained earnings should occur on an individual basis for each FHLBank within the context of the FHLBank's established capital plan.

Treatment of Non-Advance Assets

NAHB is concerned that the proposal creates a bias against FHLBank assets other than advances, without any specific consideration of the risk and risk management measures related to such assets. All non-advance assets would incur a one percent surcharge in retained earnings capital when, in fact, the credit and market risks associated with such assets vary considerably. Capital requirements for all FHLBank assets, including non-advance assets, should be established in accordance with the Finance Board's risk-based capital regulations and the FHLBank capital plans to best ensure that the FHLBanks are holding capital in the appropriate proportions to the risk of the various assets in their portfolios.

NAHB has strongly supported the development of FHLBank programs and products beyond the traditional advance business as a means for the FHLBanks to improve mission achievement in support of the housing credit activities of FHLBank members. For example, the FHLBank mortgage purchase programs, by providing FHLBank member institutions an alternative to the programs of Fannie Mae and Freddie Mac, have increased competition in the secondary mortgage market and lowered mortgage rates for home buyers.

Regardless of the intent of the proposed rule, the actual impact of the proposal would be to encourage the FHLBanks to favor advance business over other activities. NAHB disagrees with this approach and feels that the Finance Board's regulations should not arbitrarily advantage one FHLBank activity over another. FHLBanks' development and pursuit of products and services for members should be assessed in the light of members' needs and how addressing those needs complies with the mission of the FHLBank System. The FHLBanks should be required to demonstrate a capacity to pursue a specific activity and establish capital reserves that are related to the risk of that activity. An arbitrary system of capital requirements for FHLBank activities could result in excess or inadequate capital reserves and either result would impair the FHLBanks' pursuit of their mission.

Impact on FHLBank Business Activity and Mission Efforts

In addition to the adverse impact on the development of new FHLBank activities, NAHB believes the proposed rule would sharply reduce demand for existing FHLBank products and services. By the Finance Board's estimates, all but one of the 12 FHLBanks would not currently meet the proposed retained earnings requirement and most of the FHLBanks would require an extended period of time to come into compliance with the proposed standard. The restriction on dividends that would be applied in that interim period would raise the "all-in" cost of FHLBank advances and, as a result, reduce demand for advances, particularly from the FHLBanks' largest customers. The resulting fall-off in FHLBank earnings would mean diminished contributions to the Affordable Housing Programs of the FHLBanks, which are critical sources of capital for the production of affordable rental housing and the expansion of homeownership opportunities for those not served by the conventional mortgage market.

Impact on Community Bank FHLBank Members

NAHB believes the dividend restrictions that would occur under the proposed rule would have a further detrimental impact by increasing the cost of funds and reducing investment returns for the smaller member institutions in the FHLBank System. The higher all-in cost of advances would be especially hard on these smaller, community-based commercial banks and thrifts since they typically do not have access to other lower cost forms of long-term debt. In addition, many of these institutions rely heavily on FHLBank dividends as a source of income and may have difficulty in adjusting their balance sheets to offset the reduced dividend flow.

The potential adverse effect of the proposed rule on community lenders is of particular concern to NAHB members, since many home builders rely heavily on such institutions for their land acquisition, development and construction loans. Dislocations in that portion of the housing credit market could disrupt the production and increase the cost of new homes.

Conclusion

NAHB sees no valid purpose in proceeding with the proposed rule. The preamble to the proposal states that “the Finance Board believes that its capital rules and the Banks’ overall capital levels remain adequate and the risk of capital insolvency at any Bank in the foreseeable future is de minimis.” Given that outlook, along with the major adverse consequences that could result for the FHLBanks, their members, home builders and those in need of affordable housing, NAHB strongly urges the Finance Board to abandon the proposed approach. We urge the Finance Board to resume addressing FHLBank capital issues on a case-by-case basis within the framework of the risk-based capital regulations and the FHLBank capital plans.

Sincerely,

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