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December 4, 2012

Mr. Alfred M. Pollard
General Counsel
Attn: Comments/2012-N-14
Federal Housing Finance Agency
400 7th Street SW
Washington, DC 20024

Dear Mr. Pollard:

I am writing on behalf of the National Association of Mutual Insurance Companies in response to the FHFA's request for comments on a proposed Advisory Bulletin that would set forth new standards to guide agency staff in its supervision of secured lending to insurance company members by Federal Home Loan Banks (FHLBanks). NAMIC is the largest and most diverse property/casualty trade association in the country, with 1,400 regional and local mutual insurance member companies serving more than 135 million auto, home, and business policyholders and writing in excess of $196 billion in annual premiums that account for 50 percent of the automobile/ homeowners market and 31 percent of the business insurance market. More than 200,000 people are employed by NAMIC member companies. Of the 264 insurance company members of the Federal Home loan Bank system, approximately 50 are NAMIC members as well.

NAMIC appreciates the FHFA's desire to ensure that the risks arising from FHLBank lending to the banks' member companies are properly evaluated. We do not believe, however, that FHLBank lending to insurance companies warrants a higher level of scrutiny than that which is applied to commercial banks, thrifts, and credit unions.

While it is no doubt true that "FHLBanks typically face risks lending to insurance companies that differ from those associated with lending to federally insured depository institutions" (to quote from the proposed bulletin), it does not follow that FHLBanks necessarily incur *greater* risk when lending to insurers, as the proposed bulletin seems to imply. Rather, it could be argued that there is considerably *less* risk involved in lending to insurers than in lending to depository institutions. In recent decades, insurance company insolvencies have been far less common than depository institution failures.

There is good reason to believe that the risks associated with lending to depository institutions are greater than the risks associated with lending to insurers. In particular, the "super lien" has permitted depository institutions to pledge less liquid collateral (mainly loans in the form of seasoned residential mortgages and below-investment grade commercial mortgages) to obtain FHLB advances, compared to the collateral standards that insurers must meet. Insurance company collateral is more liquid because insurance company business models and state insurance regulation restrict insurer investments primarily to investment grade marketable securities. The result is that, in contrast to FHLBank loans to depository institutions, FHLB advances to property/casualty insurance companies are fully collateralized with marketable securities.

Insofar as lending to insurers poses risks that are different from (but not greater than) the risks associated with lending to depository institutions, the fact that these risks are not correlated probably has the effect of lowering the overall risk profiles of the FHLBanks. Portfolio theory suggests that the FHLBanks can reduce overall risk by diversifying risk exposures. Recognizing this, FHLBanks have reduced lending to member depository institutions by 60 percent during the last four years, while increasing member insurance company advances by more than 20 percent.

The draft advisory bulletin suggests that there are special “challenges associated with lending to insurance companies,” which it attributes to the fact that insurers, unlike depository institutions, are not subject to federal regulation and are not federally insured. However, contrary to what is suggested in the proposed Advisory Bulletin, “potential ambiguities in insurance laws” and “different approaches among states to insurance company supervision and the liquidation and rehabilitation of insurance companies” cannot result in insurance policyholders being favored over secured creditors in the event of an insurance company liquidation. State guaranty funds, which pay policyholder claims when an insurer is ordered into liquidation, can only access the remaining *general* assets of an insolvent company. The claims of secured creditors are separate from the company’s general assets, and are therefore not included in the pool of general assets from which guaranty funds draw to pay policyholder claims.

Finally, it must be emphasized that the Federal Home Loan Bank Act requires FHLBanks to underwrite the financial strength of each member institution before extending credit, and provides that loans can only be made to members on a fully secured basis. What the Act does not do is establish separate, additional lending criteria for the FHLBanks’ insurance company members that are more stringent than the criteria that apply to the banks’ depository institutions members. The guidance set forth in the proposed Advisory Bulletin, however, would do just that, effectively limiting insurers’ access to FHLBank advances.

The proposed bulletin states that while “an Advisory Bulletin does not have the force of a regulation or order, it does reflect the position of the Federal Housing finance Agency staff on a particular issue, and will be followed by examination staff.” As a practical matter, the difference between an Advisory Bulletin and a “regulation or order” appears to be a distinction without a difference. A change in policy that is as significant as that contemplated in the proposed bulletin should be determined by Congress, rather than by new administrative interpretations of long-standing regulations.

Please contact me if you have any questions or require further assistance.

Sincerely,

Robert Detlefsen, Ph.D.
Vice President, Public Policy