BY ELECTRONIC MAIL

February 7, 2012

Alfred M. Pollard, Esq.
General Counsel
Federal Housing Finance Agency
Fourth Floor
1700 G Street, N.W.
Washington, DC 20552

Re: Federal Home Loan Bank Community Support Amendments; RIN 2590—AA38

Dear Mr. Pollard:

On November 10, 2011, the Federal Housing Finance Agency (FHFA) issued a proposed rule[1] to amend its community support regulation by, among other things, requiring the Federal Home Loan Banks (FHLBanks) to monitor and assess the eligibility of each FHLBank member for long term advances, through compliance with the regulation's Community Reinvestment Act of 1977 (CRA) and first-time homebuyer standards (Proposed Rule). This letter sets forth comments of the undersigned FHLBanks on the Proposed Rule. We thank you for the opportunity to be heard on this important matter.

The FHLBanks are committed to furthering their community support mission. Over the years the FHLBanks have supported their members in providing affordable housing and community development in the communities they serve. For more than 20 years, the FHLBanks' Affordable Housing Program (AHP), funded with ten percent of the FHLBanks' net income each year, has been one of the largest private sources of grant funds for affordable housing in the United States. Each FHLBank also operates a Community Investment Program (CIP) and other Community Investment Cash Advance (CICA) programs that offer below-market-rate advances to members to support the long-term financing of housing and economic development and other targeted economic development activities benefitting low- and moderate-income families and neighborhoods. In addition to these community investment programs and services, the FHLBanks also help facilitate the FHFA's regulatory oversight of FHLBank members' compliance with the FHFA's Community Support program regulation. We believe this role as facilitator is both appropriate and effective.

The current community support regulation, at 12 C.F.R. Part 1290 (Community Support Regulation), operates efficiently, effectively, and economically. The FHFA's guidance and leadership in this matter have been particularly strong. In 1993, when the Federal Housing Finance Board

[1] 76 Fed. Reg. 70069 (2011).

(FHFB) promulgated the Community Support Regulation, the FHFB indicated its intention to "strike a balance between the policy goals of Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) and enhancing the FHLBank System's role as a community lending partner, and at the same time not impairing the System's attractiveness to new members."[2] We believe that the FHFA, and the FHFB before it, have succeeded in this goal. The undersigned FHLBanks therefore offer our comments in the spirit of further improving a system that works.

The Proposal to transfer to the FHLBanks the responsibility for evaluating member compliance with the Community Support Regulation raises significant concerns. These concerns include questions about the appropriateness of transferring a role in supervising member regulatory compliance to the member-owned FHLBanks; increased costs of compliance; loss of nationwide consistency; creation of inherent conflict for the FHLBanks acting in a supervisory role with respect to their members and customers; and the impact of these factors on the quality of community support enforcement. The proposed regulation would undermine the value of the FHLBanks' relationships with their members by putting the FHLBanks in the role of compliance supervisors as opposed to business partners and their customers. As further explained below, as between the FHFA and the FHLBanks, the FHLBanks respectfully submit that the FHFA, as an independent agency in the executive branch of the federal government, is the only appropriate party to determine and enforce members' compliance with the FHFA's Community Support Regulation.

In the preamble to the initial Community Support Regulation adopted in 1991,[3] the FHFB cited overwhelming opposition to an FHLBank acting as a business partner and as a regulator or supervisor in relation to its members:

> Any role of the FHLBanks in reviewing and rating members' Community Support was overwhelmingly opposed by the commenters; 54 of the 56 comment letters addressing this issue were opposed to the FHLBanks' role as outlined in the Proposed Rule. These comment letters came from a range of sources, including FHLBanks, Advisory Councils, FHLBank members, community groups, Congress, and financial trade associations. The reasons for opposition varied, but in essence, the comment letters all objected to any Finance Board delegation of responsibilities to the FHLBanks on the grounds that this would create a perception that the FHLBanks were returning to a pre-FIRREA role as industry regulators, a function FIRREA had eliminated.[4]

The FHFB recognized the reasoning that acting as a regulator or supervisor created at least the appearance of a conflict, and decided not to give such power to the FHLBanks.

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[2] *See*, *e.g.*, 58 Fed. Reg. 46569, 46573 (Sept. 2, 1993).

[3] 56 Fed. Reg. 58639 (November 21, 1991).

[4] 56 Fed. Reg. at 58640.

> However, the Finance Board recognizes the difficulties and possible perceived conflicts that could arise if the FHLBanks were placed in a substantive evaluative role. Therefore, in the final rule, the FHLBanks have no evaluative responsibilities over member institutions. The FHLBanks are assigned a number of administrative responsibilities and will be required to provide technical assistance to members both by working with the member directly in developing a Community Support Statement, Community Support Action Plan, and through Bank programs, as specified in § 936.8. The administrative responsibilities that are assigned to the FHLBanks will consist of reviewing the Community Support Statements for completeness, notifying a member if the statement is incomplete, and forwarding to the Finance Board completed Community Support Statements, comment letters or other information received during the public comment period, as well as a list of members with incomplete or missing statements.[5]

In fact, the FHFB viewed the elimination of FHLBank presidents' designation as a supervisor as positive.

> Traditionally, the FHLBank Presidents served as Principal Supervisory Agents, on behalf of the government, in regulating their members. The removal of these responsibilities has restored a customer relationship between the FHLBanks and their members.[6]

Congress was even more forceful in its rejection of a supervisorial function for the FHLBanks. When the House of Representatives' Banking Committee adopted its version of the report that would become FIRREA, it specifically noted the problems with having the Federal Home Loan Banks exercise supervisory authority over its members, who owned the FHLBanks, as follows:

> Although the Bank Board controls the supervisory machinery that oversees the thrift industry, it has delegated much of this responsibility to the presidents of the 12 district banks. The district bank presidents, entrusted with the responsibility of examination and supervision, are themselves elected directly by the industry—the very industry being examined by the district banks. The district banks also serve as a credit facility making loans to member institutions. The system is rife with real and potential conflicts of interest which compromise the integrity of the regulatory, insurance and credit functions of the Federal Home Loan Bank System.[7]

Transferring supervision of member compliance from an independent agency in the executive branch of the federal government to the member-owned Federal Home Loan Banks is questionable policy, and raises the same unavoidable appearance of a conflict of interest that Congress decided to

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[5] *Id.* at 58644.

[7] Financial Institutions Reform, Recovery and Enforcement Act of 1989, Report of the Committee on Banking, Finance and Urban Affairs, House of Representatives, Rept. 101-54, Part 1, pp. 424-425 (May 16, 1989).

abolish in FIRREA. Indeed, some may argue that the appearance of a conflict of interest would be worse than before FIRREA because now all the Federal Home Loan Bank directors are elected by the members,[8] and previously the typical board of directors consisted of eight elected directors and six directors appointed by the federal agency.[9]

The FHLBanks are particularly reticent to exercise a regulatory or supervisory role over their members in light of the inherent conflict of having the FHLBanks act as a compliance supervisor of their members, on one hand, and as the members' lender, on the other. The FHLBanks had this dual role prior to FIRREA, and the inherent conflict became apparent during the thrift crisis in the 1980s. In response to that crisis, Congress – concerned by the conflict of interest that then existed in the FHLBank System[10] – created the Office of Thrift Supervision in FIRREA to ensure that the FHLBanks would act solely as a lender, and not as a supervisor, to their members. The Proposed Rule requires the FHLBanks to evaluate community support efforts of their members, with severe consequences to members for noncompliance. This would re-create a conflict of interest that Congress eliminated through FIRREA in 1989, and that Congress confirmed with the passage of the Housing and Economic Recovery Act of 2008 (HERA). Congress has deemed it inappropriate for the FHLBanks to exercise supervisory judgment over their own members.

The transfer of supervisorial power from a federal agency to the FHLBanks raises questions about the effectiveness of enforcing member compliance with the Community Support Regulation. The FHFA, as a federal agency, has a well trod administrative path to enforcing final agency actions under its promulgated rules, the Administrative Procedure Act (APA),[11] and a well developed body of law in the federal courts that has a broad set of standards, privileges and immunities, and presumptions that encourage an agency to act and generally favor upholding actions by a federal agency. The FHLBanks are not federal agencies for purposes of the APA, and would have few, if any, of the procedural benefits and legal protections afforded the FHFA in any potential dispute with a member over Community Support Regulation compliance. So in addition to placing the FHLBanks at risk for supervisory matters not fully within their control to resolve, the FHFA could be less likely to see its desired results in particular matters if this function is transferred to the FHLBanks.

Section 10(g) of the Federal Home Loan Bank Act (Bank Act) contains a broadly worded instruction to the FHFB to adopt the Community Support Regulations; these became Part 1290. We are aware of nothing, however, in the Bank Act that would somehow cloak the proposed activities of the

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[8] 12 U.S.C. 1427(a)(3).

[9] The current formulation of electing all directors was added in the Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, § 1202 (July 30, 2008).

[11] Pub. L. No. 79-404 (June 11, 1946) (codified at 5 U.S.C. § 500 *et seq.*)

FHLBanks in this arena with the mantle of authority of the federal government. Apart from a general reference to section 10(g) of the Bank Act,[12] the Proposed Rule does not set forth the basis for the FHFA's determination that it can delegate community support evaluation duties to the FHLBanks or that the FHLBanks have the power to perform such duties.[13]

Looking outside the Bank Act, to Section 1102(a) of HERA,[14] the Director of the FHFA is expressly authorized to delegate his duties to the officers and employees of the FHFA itself, which would not apply to this circumstance. We are not aware of other implicit authority upon which the FHFA may be relying for this proposed transfer of functions. The FHLBanks therefore request that, should the FHFA adopt the Proposed Rule substantially unchanged, the FHFA clarify in the Final Rule how it intends the FHLBanks should exercise their powers in a dispute with a member, and how the FHFA intends to continue to exercise its authority as the appropriate agency of the federal government.

The Proposed Rule also contains other provisions that raise questions about our ability to act consistent with Congressional judgment on the FHLBanks' proper role as lenders and not as compliance supervisors. For example, proposed § 1290.3(b) would potentially require the FHLBanks to second-guess the determination of a member's appropriate federal regulator (or state regulator if there is no federal regulator) that the prohibition on access to long-term advances may adversely affect the member's safety and soundness. Such decisions by the FHLBanks could only highlight the conflict between serving as a compliance supervisor and serving as a lender in a cooperative structure. The FHLBanks are not in a position to question a regulator's judgment in these sensitive cases. We therefore request guidance from the FHFA on the circumstances where, notwithstanding the appropriate federal or state regulator's determination that prohibiting long-term advances may adversely affect the member's safety and soundness, the FHLBanks should impose such a restriction anyway.

Similarly, the FHLBanks request guidance on the policies and procedures to be adopted by the FHLBanks pursuant to the Proposed Rule. For example, the FHLBanks seek guidance on how these policies and procedures should address such matters as the process of FHLBank review, member appeals of FHLBank determinations, consideration of additional evidence in the case of appeals, the proper weight to be given consumer comments, and the process for promulgating and amending such policies and procedures. Should the FHLBanks be called upon to exercise these new powers, we would want to ensure we do so within known, proper parameters, particularly given the limited statutory guidance for this role.

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[12] *See* Proposed Rule at 70069.

[13] Previously, the FHFB was barred expressly by the Bank Act from delegating any function to an FHLBank. FIRREA 702; *formerly codified at* 12 U.S.C. § 4522b (prohibiting delegation of FHFB duties to FHLBanks or FHLBank administrative units, joint offices, or employees).

[14] *Codified at* 12 U.S.C. § 4513(d).

The FHLBanks observe that federal agencies, such as the FHFA, and U.S. Government employees are often entitled to immunity (which may be qualified) for performing their duties as supervisors.[15] One authority has noted:

> Immunity is designed to prevent officials from feeling constrained in the performance of their duties by fear of damages suits. For employees whose jobs involve a high degree of discretion, this protection is significant. Also, immunity preserves the independent judgment of officials, who otherwise might be influenced by the threat of retaliatory lawsuits. Lastly, the government functions more efficiently because employees do not have to divert valuable time and resources to defending what might be frivolous charges.[16]

In the absence of a clear determination that the FHLBanks would have immunity in such cases, we believe that it is more appropriate to leave the exercise of supervisorial discretion in the hands of the FHFA.

The Proposed Rule will increase the cost of evaluating compliance with the community support standards. We expect these costs to be substantial and weigh heavily against adopting the Proposed Rule as written. The FHLBanks note that the Proposed Rule omitted any consideration of the costs to the FHLBanks of undertaking the new responsibilities outlined in the Proposed Rule. Even though the Proposed Rule considered the expected costs to members and the FHFA, the FHLBanks' costs should be considered as well.

If the Proposed Rule is adopted as written, the FHLBanks would be required to create and maintain policies, procedures, and systems to evaluate member compliance with the Community Support Regulation. Thus, rather than having a single FHFA apparatus to regulate community support compliance, each of the twelve FHLBanks would be required to create and maintain its own supervisory apparatus (albeit of a limited scope), and the FHFA would be required to expand its own supervisory operations to permit it to supervise twelve new community support compliance supervisors. The FHLBanks and their members will directly bear the costs of the new FHLBank activities, and will indirectly bear the costs of expanded FHFA operations through increased FHFA assessments. We believe that duplicating FHFA's existing structure in each of the twelve FHLBanks, and building this additional supervisory capacity within the FHFA, will substantially increase the costs of evaluating compliance with the Community Support Regulation.

Similarly, the FHFA asserts that "[r]equiring the Banks to adopt policies and procedures for community support evaluations, to conduct the evaluations, and to make decisions on any

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[15] *See, e.g.*, *Butz v. Economou*, 438 U.S. 478, 512-13 (1978).

[16] Charles A. Wright & Charles H. Koch, Jr., Federal Practice & Procedure § 8320 (Westlaw 1st ed. 2012).

restrictions on access to long-term advances, would be consistent with their general advances underwriting responsibilities."[17] The FHLBanks respectfully disagree. The FHLBanks underwrite advances and other credit products on the basis of prudent credit risk and collateral assessment to ensure repayment. The FHLBanks are wary of including considerations unrelated to repayment risk and collateral quality in their credit underwriting activities.

For its greater costs, the Proposed Rule may bring inconsistent, inferior results. The Proposed Rule contemplates that each of the twelve FHLBanks must develop its own community support evaluation policy and procedures. The FHLBanks do not perceive a material benefit in having twelve different sets of policies and procedures for evaluating compliance with the Community Support Regulation, particularly if (as the FHLBanks request) the standards themselves remain nationally uniform. By contrast, under the current regulation, FHFA has only one evaluation standard nationwide, so all members across the System benefit from consistent standards that are uniformly applied and the efficiencies and cost savings that come from economies of scale. Moreover, no FHLBank has the regulatory or supervisory skills currently held by the FHFA. It is not clear how the policies behind the Community Support Regulation will be advanced by replacing one experienced federal agency with twelve inexperienced FHLBanks acting as compliance supervisors.

The Proposed Rule presents several questions that the FHFA has raised with respect to the current and proposed future operations of the Community Support Regulation. We thank the FHFA for the opportunity to comment on these important questions.

The FHFA has asked whether the public comment process would be enhanced if the FHLBanks were required to give public notice when specific members are selected for community support review, or whether such notice should be at the discretion of each FHLBank. The current public notice provisions seem to be working effectively. The FHLBanks believe that the FHFA should continue, as a federal public agency, to be the organization to solicit and receive public comments about member community support compliance.

The FHLBanks are concerned about the proposed process for receiving and evaluating consumer comments about members and are not structured to handle supervisory enforcement matters that might arise in connection with the proposed process.

The FHFA has asked whether the definition of "first-time homebuyer" should be removed, whether the definition should be maintained in its current form, or whether the definition should be revised to reflect the statutory amendment that addressed previous ownership of manufactured or substandard housing. The FHLBanks believe that it is important to retain the

[17] Proposed Rule at 70070.

benefits of uniformity in this definition for all FHLBank members, regardless of jurisdiction. Therefore, the FHLBanks support retaining this definition within Part 1290.

In reviewing the FHFA's question about the definition of "first-time homebuyer," the FHLBanks have evaluated the definitions they use for this term in other contexts. Most closely related to this context are the FHLBanks' Affordable Housing Programs. Although the FHLBanks use varying definitions of first-time homebuyer, Section 104 of the Cranston-Gonzalez National Affordable Housing Act, as currently in effect (Cranston-Gonzalez Act),[18] is the definition used by a majority of the FHLBanks. The FHLBanks therefore propose that the definition of "first-time homebuyer" be included in the Community Support Regulation and that the definition track the statutory definition set forth in the Cranston-Gonzalez Act.

The FHFA has asked whether members with a single CRA rating of "Needs to Improve" should be restricted from accessing long-term advances, or whether the members should be placed on probation, maintaining access to long-term advances pending their next CRA rating, similar to existing practice. The FHLBanks believe that the current practice should be maintained. The FHFA noted, and the FHLBanks agree, that restricting a member's access to long-term advances after a single CRA rating of "Needs to Improve" "could restrict a member's ability to use long-term advances to address the deficiencies that led to the 'Needs to Improve' rating."[19] At a minimum, any final rule that retains this provision should expressly permit such members to continue to participate in the AHP, CIP, and CICA program, as they may offer an effective strategy for members to comply with CRA's requirements.

We believe that the uncertainty and potential disruption created by removing the probationary period increases the risk that FHLBank liquidity and advances will not be available when they are needed. This undermines members' ability to count on the availability of long-term advances if they can be eliminated immediately for CRA deficiencies. Moreover, we do not believe that reducing the availability of long-term advances furthers the FHLBanks' housing and community support missions. We believe that constructive engagement during the probationary period is a more effective way to improve a member's CRA performance – and meet the policy objectives of the Community Support Regulation – without undermining the value of FHLBank membership.

We agree with the FHFA's observation that this issue has not often arisen. The FHFA noted that "slightly more than two percent of institutions that were subject to CRA evaluations from 2008 to 2010 received ratings of 'Needs to Improve.'"[20] The Proposed Rule does not state what proportion

[18] *See* 42 U.S.C. § 12704(14).

[19] Proposed Rule at 70072.

[20] *Id.*

of those institutions were FHLBank members that improved, or failed to improve, their CRA ratings during the probationary period. The FHLBanks do not believe that there are sufficient data to quantify the impact of the Proposed Rule, let alone to support the conclusion that the policy objectives of the Community Support Regulation can be better met by immediately restricting access to long-term advances. On the other hand, we believe that the business, liquidity, and safety-soundness risks to members, and the harm to the value of the FHLBank membership (including reliable access to AHP, CICA, and CIP), created by removing the probationary period are quite real.

The FHFA has asked whether the proposed list of first-time homebuyer programs and activities should be revised in any way, and about the degree of discretion the FHLBanks should be given in determining what programs and activities are eligible to meet the first-time homebuyer standard. The FHLBanks support listing all identifiable and qualifying first-time homebuyer programs and activities within Part 1290. Specifically, we support retaining the program and activity list set forth in current § 1290.3(c), and adding any new qualifying programs and activities set forth in proposed § 1290.6(a), including new programs that an FHLBank may identify pursuant to proposed § 1290.6(a)(12).

The FHLBanks support retaining all programs currently covered by § 1290.3(c) within the final rule. Members have relied upon this list in creating compliant programs, and we believe there is substantial value in continuity of these programs. We further support adding categories of qualifying first-time homebuyer programs along the lines identified in the Proposed Rule, but believe that these new programs should supplement and not replace the list of currently-qualifying programs.

Finally, we believe that the benefits of national uniformity and completeness are compelling, but we also recognize there could be benefits in allowing FHLBanks to review, in consultation with their respective Advisory Councils, new programs and activities proposed by their members and assist the FHFA in determining if those proposed programs and activities are eligible to meet the first-time homebuyer standard. This discretion would allow the FHLBanks and their members to respond to an ever-changing housing market, without the need for implementing regulatory action, but still subject to the FHFA's supervision. For example, while we understand the Federal Home Loan Bank Act and implementing regulations focus on first-time homebuyer programs and activities, we note that a broader focus on "income-eligible households and neighborhoods" may allow more members to satisfy this requirement, rather than looking only at whether a program is geared to "first-time homebuyers." A member that engages in a substantial program to provide refinancing or home improvement lending to "income-eligible households and neighborhoods" could be viewed as satisfying many of the same policy goals as the first-time homebuyer standard, and should be supported in their efforts.

The FHFA has asked whether a member should be required to engage in more than one eligible first-time homebuyer program or activity in order to be in compliance with the first-

time homebuyer standard, and if so, how many programs or activities should be required. The FHLBanks believe that members should be required to participate in only one first-time homebuyer program or activity to be in compliance with the first-time homebuyer standard. The cost of developing an additional first-time homebuyer program could be significant. The FHLBanks are also concerned that, by requiring some higher number of first-time homebuyer activities to be undertaken, members that could effectively operate one program would find their financial, personnel, and other resources overtaxed by operating multiple programs and thus would be less effective overall. Moreover, such programs are more difficult to add in today's troubled economic conditions. The FHLBanks therefore support the FHFA's proposal to require only one such program to satisfy the first-time homebuyer standard.

Apart from the firm belief that the current supervisory responsibility should not be transferred to the FHLBanks, the FHLBanks would welcome an opportunity to work collaboratively with the FHFA to find ways that the current community support regulatory system can be streamlined. The FHLBanks believe that the guiding principle of such refinement should be to preserve the difference between the FHFA's regulatory function and the FHLBanks' lending role. Furthermore, the FHLBanks believe that a comprehensive discussion of process, procedure, and policy related to the Community Support Regulation could identify opportunities for enhancing efficiency and reducing costs, without reducing regulatory effectiveness for this mission-critical aspect of the FHLBank System.

For example, the FHLBanks believe that Part 1290 may be enhanced as to members subject to CRA by integrating CRA examinations and FHFA community support evaluations. We note that each of the primary federal regulators for insured depository institutions announces in advance the entities scheduled for CRA examinations in each quarter.[21] Public comments are invited in these examinations.[22] The FHLBanks would support efforts to integrate the FHFA's community support review, as well as the FHLBanks' member outreach and technical assistance, with a member's primary federal regulator's CRA evaluation. As more than 82% of FHLBank members are subject to CRA examination, this provides a meaningful opportunity to coordinate, simplify, and reduce costs. This would also provide the most timely information for community support compliance about members subject to CRA. Coordination is more efficient and cost-effective than requiring the FHFA or each of the FHLBanks to establish systems to determine whether the Federal Financial Institutions Examination Council or the primary federal regulator has updated its website to reflect

[21] See, as to the FDIC, 12 C.F.R. § 345.45 and http://www.fdic.gov/regulations/community/exam/index.html; as to the OCC, 12 C.F.R. § 25.45 and http://www.occ.gov/topics/compliance-bsa/cra/community-reinvestment-evaluations-coming-due.html; and as to the Federal Reserve, 12 C.F.R. § 228.45 and http://www.federalreserve.gov/apps/crape/DistrictSchedule.aspx.

[22] *See* 12 C.F.R. §§ 345.29(b), 25.29(c), and 228.29(b).

that one of more than 5,500 FHLBank members subject to CRA examination may have received a deficient CRA examination result.

If the Proposed Rule is adopted as written, the FHLBanks would be required to substantially change their relationships with their members and their community support operations. Developing necessary policies and procedures, conducting necessary assessments, and implementing new supervisory controls and processes (including, potentially, new or modified risk management systems) will be a significant effort requiring substantial time, and which likely will put conflicting demands on resources otherwise engaged in implementing other regulatory initiatives. In addition, the FHLBanks would be subject to added risks if they were required to evaluate and make regulatory compliance determinations with respect to member community support compliance. For these reasons, we request that the Proposed Rule not be adopted in its current form.

Thank you for your consideration of our comments.

Sincerely,

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Federal Home Loan Bank of Boston

Edward A. Hjerpe III
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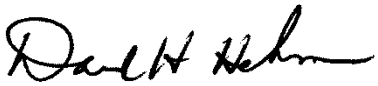

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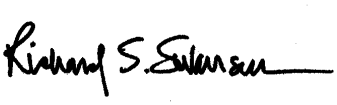

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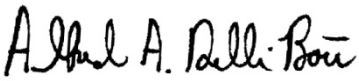

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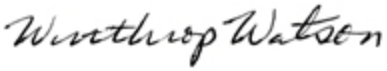

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