



SINCE 1902

CONFERENCE OF STATE BANK SUPERVISORS

January 09, 2015

Alfred M. Pollard
General Counsel
Federal Housing Finance Agency
400 Seventh Street SW., Eighth Floor
Washington, DC 20024

Re: Proposed Revisions to Federal Home Loan Bank Membership Requirements
RIN 2590-AA39

Dear Mr. Pollard:

The Conference of State Bank Supervisors (“CSBS” or “state regulators”) appreciate the opportunity to comment on the Federal Housing Finance Agency’s (“FHFA” or “the agency”) proposed revisions to the regulations that govern Federal Home Loan Bank (FHLB) membership. State banking departments serve as the chartering agency and primary regulator for the majority of the nation’s community banks, most of which are FHLB members. FHLB advances and fund matching on long term loans are critical sources of liquidity for community banks across the country. Access to FHLB membership promotes stability and growth within housing finance markets, and furthers home ownership within local communities across the country. State regulators are focused on ensuring that the FHLB banks continue to remain a stable and strong source of funding for community banks.

The FHFA’s revisions to membership requirements, as proposed, would have a detrimental effect on FHLB members and the FHLB system as a whole. Specifically, the FHFA’s proposal to impose ongoing mortgage asset threshold tests on new and current members could lead to community banks unnecessarily losing a stable and critical source of funding through termination of their FHLB membership.

As our economy recovers, the FHFA should ensure that any new regulation imposed on community banks and insurance companies is necessary for safety and soundness reasons. The proposed revisions to the FHLB membership regulations will impose unnecessary compliance burdens on financial institutions that have demonstrated a commitment to housing finance and depend upon the FHLB system for necessary liquidity.

PROPOSED MORTGAGE ASSET TESTS

The FHFA’s proposal would impose ongoing mortgage asset requirements that all members would need to meet in order to maintain their FHLB membership. Specifically, all depository institution members or prospective members (except Community Financial Institutions (CFI’s)) would be required to hold at least 10% of their assets in “residential mortgage loans” at the time of application and on an ongoing

basis. In addition, all FHLB members would be required to hold one percent of assets in “home mortgage loans” (first lien single and multi-family mortgages with original terms of five years or longer and MBS and CMOs backed by such mortgages) to satisfy the statutory requirement that an institution make long-term home mortgage loans.

The FHFA’s proposal runs contrary to the direction and goals that Congress has set for the FHLB system. Since the creation of the system, every statutory action related to membership has broadened the potential membership base. The 1989 Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA), the Gramm-Leach-Bliley Act (GLBA) of 1999, and Section 1201 of the 2008 Housing and Economic Recovery Act (HERA) each clarified the role of the FHLB’s and widened the scope of access to the system. A specific example of Congresses’ intent to ensure a diverse and expanded FHLB membership base can be found in statutory amendments to HERA. With the amendments, Congress acted to ensure that Community Development Financial Institutions (CDFIs) are able to access FHLB membership. In 2010 the FHFA issued a final rule that implemented the congressional amendments to help facilitate CDFI membership in the FHLB system. Imposing ongoing membership requirements on CDFIs would conflict with congressional intent and the FHFA’s 2010 final rule.

The proposed ongoing asset tests will increase reporting costs for current and prospective members as well as monitoring costs for FHLBs. In addition, the proposal creates unnecessary uncertainty for member entities, who will need to ensure that their institutions do not fall below the proposed thresholds in a given quarter. Certain community bank members, including seasonal lenders, may need to adjust their lending practices if they wish to remain FHLB members. Members could also fail asset tests due to merger and acquisition activity. For example, a member that acquires an institution with limited housing related assets could cause the member to fall below the threshold.

As currently proposed, community banks that grow in excess of the CFI asset cap set by HERA (currently \$1.108 billion) will need to meet the 10% residential mortgage loan test or face termination of their membership. Meeting the requirement could be a challenge, considering that the banks will have only one year to restructure their balance sheet to comply with a requirement based on a three year rolling average. Banks in this situation would not have been subject to the 10% requirement in the two previous years that are used to calculate the average.

If the proposed revisions are finalized, current and prospective members will be left to guess whether the FHFA will raise asset thresholds in the future. The FHFA has requested comment on whether they should increase the proposed ongoing one-percent requirement to five percent. State regulators strongly oppose this consideration and note that a threshold of five-percent could lead to the termination of membership for many current members who are in good standing.¹

¹ In comments submitted by the Federal Home Loan Bank of Chicago, the bank noted that 46 percent of current insurance company members would fail the asset test if it were set at five percent. In an interview published in the American Banker, FHLB Chicago President Matt Feldman stated that “the proposed regulation would eliminate between \$230 and \$350 billion of borrowing capacity just from the members that would have failed to qualify over the past five years, and as a result, would have become ineligible for FHLB membership.

Current regulations work well to ensure that members are supporting the housing finance mission of the FHLB's. FHLB membership is voluntary and collateral requirements imposed by the FHLBanks promote responsible asset compositions. Through these collateral requirements, the FHLB's are able to ensure that the uses of advances are linked to the holdings of the members who obtain them. In addition, the amount of long-term advances that a member can receive is limited by the amount of total long-term residential housing assets held by the member. The proposed asset tests are arbitrary, and provide no credit for originating loans sold into the secondary market or for other types of loans which the FHLBanks consider to be mission-related, including those made to CFI's, small businesses, or loans for agricultural purposes. The FHFA's proposal would remove the FHLB's ability to work with members on a case by case basis and instead would force members into a rigid and unforgiving membership framework contrary to the intentions of Congress.

The proposal states that the proposed on-going tests are necessary to avoid the possibility that an entity could rid themselves of mortgage holdings after membership is approved. If this is the case, the FHFA should provide data or other evidence to support their claim that this is a widespread issue. As currently proposed, the FHFA has failed to justify the proposed revisions are a response to an actual problem.

PROPOSED INSURANCE COMPANY DEFINITION

The FHFA's proposed definition of "insurance company" would exclude captive insurers from membership eligibility. The proposal is based on the agency's "belief" that captives may be used by other companies, such as real estate investment trusts (REITS), to access FHLB funding. REITS may pose unique risks to the FHLB system, and state regulators agree that REITS without a clear nexus to insured depository institutions should not be allowed to use captive insurers to access FHLB advances.

Rather than banning captive insurance membership entirely, the FHFA should more clearly identify the risks that are believed to be posed by captive insurance companies and adopt rules to address the particular practices that would threaten the safety and soundness of the FHLB System. As is currently the case, the FHLBs should be allowed to continue to exercise discretion in determining the purpose of a particular captive's application for membership. Certain depository institutions and state bank associations work with captive insurers to fund lending, and provide liability coverage or other insurance products. The FHFA should amend their proposal to allow the membership of captives who serve the purposes of otherwise eligible members. As currently written, the proposed rule will create unintended consequences for depository entities that have a nexus to captive members.

Insurance companies have been eligible to become FHLB members since the creation of the FHLB system in 1932. If the FHFA has broad concerns regarding captive insurers, they should be raised in annual reports to Congress.

CONCLUSION

State regulators support existing membership regulations, which ensure that there is a connection between member's holdings and borrowings. The FHLB System serves as a reliable source of liquidity for their member institutions in support of housing finance and community lending. The FHLB's have

successfully demonstrated an ability to support its members through the recent financial crisis. By imposing ongoing requirements that could lead to membership termination, current members can no longer be certain that they will have access to reliable funding in times of stress. Overall, the proposed revisions would discourage voluntary membership in the system and diminish the reliability of the FHLB's as a stable source of liquidity.

In the midst of changing regulatory requirements, including the implementation of Basel III and multiple mortgage rules, the FHFA should ensure that their oversight of the FHLB system does not halt the flow of liquidity for housing finance and community development. It is critical that the system remains a reliable source of liquidity, and that the voluntary relationship between the FHLB's and its members is not damaged by unduly burdensome membership requirements.

Thank you for the opportunity to comment.

Sincerely,

A handwritten signature in black ink, appearing to read "John W. Ryan". The signature is fluid and cursive, with a prominent initial "J" and a long, sweeping underline.

John W. Ryan
President & CEO