FEDERAL HOME LOAN BANK MEMBERSHIP

REQUEST FOR INPUT

February 2020

Division of Federal Home Loan Bank Regulation

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Introduction

Membership in the Federal Home Loan Bank System (System) affords institutions certain benefits, including the ability to obtain low-cost loans—called advances—and other financial products and services from the regional Federal Home Loan Bank (FHLBank) of which they are a member. The Federal Home Loan Bank Act (FHLBank Act) and the regulations thereunder establish certain requirements for institutions to be eligible for FHLBank membership, which help to promote the System's mission of providing liquidity to support housing finance and furthering affordable housing and community development.

As part of a holistic review of FHLBank membership, the Federal Housing Finance Agency (FHFA) is seeking public input on whether, in light of recent developments within the System and changes in the nation's housing finance markets, FHFA's existing regulation on FHLBank membership, located at 12 CFR part 1263, remains adequate to ensure (i) the System remains safe and sound and able to provide liquidity to members "through the cycle" and (ii) the advancement of the FHLBanks' housing finance and community development mission. FHFA is seeking input on several broad questions relating to FHLBank membership requirements, as well as on certain more specific questions related to the implementation of the current regulation.

FHFA last initiated a major review of the membership regulation in 2010, which resulted in a final rule in 2016.[1] The 2016 final rule effectively banned captive insurance companies—which were then being used principally by entities not themselves eligible for membership as conduits to gain access to FHLBank funding—from FHLBank membership and made several other more minor revisions to the membership regulation. In 2017, FHFA again amended part 1263 to implement new statutory provisions making certain credit unions without federal share insurance ("non-federally insured credit unions" or "NFICUs") eligible for membership.[2]

Since that time, questions regarding FHLBank membership have continued to arise. For example, on several recent occasions FHLBanks have improperly applied regulatory provisions on membership eligibility when assessing applications, resulting in a number of erroneous membership approvals. FHFA also has encountered instances in which entities that are ineligible for membership have attempted to gain access to FHLBank advances through the use of conduit arrangements with other types of affiliates that may themselves be eligible for membership.

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[1] *See* 81 Fed. Reg. 3246 (Jan. 20, 2016). FHFA initially published an advance notice of proposed rulemaking in 2010 requesting comments on numerous membership related topics, *see* 75 Fed. Reg. 81145 (Dec. 27, 2010), followed by a notice of proposed rulemaking in 2014, *see* 79 Fed. Reg. 54848 (Sept. 12, 2014).
[2] *See* 82 Fed. Reg. 25716 (June 5, 2017).

Entities that are not eligible for FHLBank membership, yet that may participate in the residential mortgage market, also have more generally continued to advocate for access to the low-cost wholesale funding that FHLBanks provide. In its September 2019 Housing Reform Plan, the United States Department of the Treasury (Treasury) recommended, among other things, that FHFA consider whether expanding access to FHLBank funding may be warranted in certain circumstances.[3]

The goal of FHFA's current membership review is to develop a set of principles and requirements of general applicability to address these and other membership issues on a consistent basis, guided by the twin objectives of ensuring that the System remains safe and sound and able to provide liquidity for housing finance through the housing and business cycle, and ensuring that all members have an appropriate nexus to the housing finance and community development mission of the FHLBanks. FHFA will consider the public input solicited here in determining what actions may be appropriate, if any, to update the FHLBank membership regulation. If FHFA determines changes are warranted, it would expect to address those through a subsequent rulemaking.

[3] UNITED STATES DEPARTMENT OF THE TREASURY, HOUSING REFORM PLAN PURSUANT TO THE PRESIDENTIAL MEMORANDUM ISSUED MARCH 27, 2019 (Sept. 2019).

Background

I. Overview of Federal Home Loan Bank Membership Requirements

A. Statutory Requirements

The System consists of eleven district FHLBanks and the Office of Finance. The FHLBanks are wholesale, cooperatively-owned financial institutions, the debt of which is the joint and several obligation of all eleven FHLBanks. They are organized under authority of the FHLBank Act to serve the public interest by enhancing the availability of residential housing finance and community lending credit through their member institutions and, to a very limited extent, through certain eligible nonmembers.[4] In general, only members may obtain advances and access other products and services provided by a FHLBank.[5]

The FHLBanks carry out their public policy function primarily by providing low-cost loans, known as advances, to their members. These must be fully secured by one or more specific types of collateral, including residential mortgage loans and residential mortgage-backed securities, but also government securities, cash, other real estate-related collateral, and, in some cases, secured small business, agriculture, or community development loans, or securities backed by such loans.[6] In most cases, FHLBank members must use the proceeds of long-term advances (defined by regulation to be advances with an original term to maturity of more than five years)[7] to fund residential housing finance, although, since 1999, smaller bank and thrift members (called "community financial institutions" or "CFIs") have also been permitted to obtain long-term advances to fund small business, small farm, small agri-business, and community

[4] *See* 12 U.S.C. §§ 1423, 1431(e), 1432(a). *See also Fahey v. O'Melveny & Myers*, 200 F.2d 420, 446 (9th Cir. 1952) (stating that a FHLBank is "a federal instrumentality organized to carry out public policy"); *ADAPSO v. FHLBB*, 568 F.2d 478, 480 (6th Cir. 1977) (stating that the FHLBanks remain federal instrumentalities although their stock is now held entirely by private entities). In addition to advances to members, the FHLBank Act also authorizes the FHLBanks to make advances to nonmember mortgagees, including state housing finance agencies, that have been approved under title II of the National Housing Act, 12 U.S.C. § 1707, *et seq*., and that meet certain additional requirements. *See* 12 U.S.C. § 1430b. These entities are referred to as "housing associates" in FHFA's regulations. *See* 12 CFR 1201.1, 1264.1-.6, 1266.16-.17.

[5] *See* 12 U.S.C. §§ 1429, 1430(a)(1), 1430b.

[6] 12 U.S.C. § 1430(a)(3).

[7] *See* 12 CFR 1266.1.

development activities.[8] FHLBank members may use the proceeds of shorter-term advances for any business purpose. The FHLBanks also may provide members with a limited range of other products and services, such as their "acquired member asset" (AMA) programs, under which they may purchase qualifying residential mortgage loans from their members.[9]

As government-sponsored enterprises, the FHLBanks have been vested by Congress with certain market advantages that enable them to raise funds in the capital markets at interest rates only slightly higher than those on comparable Treasury instruments.[10] The FHLBanks therefore can provide low-cost wholesale funding to their member institutions to help those members, in turn, provide long-term home mortgage loans to consumers at a reasonable cost. FHLBank members benefit from a lower cost of funds, which in general improves their competitiveness with non-members who do not have such access and improves their ability to manage liquidity and other risks.

In line with the public policy goals underlying the creation of the FHLBanks, Congress limited the benefits of FHLBank membership to the types of financial institutions listed in section 4(a) of the FHLBank Act. When the statute was originally enacted in 1932, these included various thrift institutions that existed at the time (*i.e.*, building and loan associations, savings and loan associations, cooperative banks, homestead associations, and savings banks), as well as insurance companies. Since 1932, Congress has expanded the list of institutions eligible for FHLBank membership three times, adding federally insured commercial banks and credit unions in 1989,[11] non-depository Community Development Financial Institutions (CDFIs) in 2008,[12] and NFICUs in 2015.[13] Any entity that does not fall within one of the categories enumerated in the statute is ineligible for FHLBank membership.

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[8] *See* 12 U.S.C. § 1430(a)(2). To qualify as a CFI, a depository institution also must be insured by the Federal Deposit Insurance Corporation, and must have total assets of less than $1 billion, which amount is adjusted annually for inflation. 12 U.S.C. § 1422(10).

[9] *See* 12 CFR part 1268.

[10] These advantages include: the exemption of earnings from state and federal income taxes, *see* 12 U.S.C. § 1433; the classification of the FHLBanks' debt as "exempted securities" and as "government securities" under federal securities laws, *see* 12 U.S.C. § 1426(c)(2); and the authority of the Treasury to purchase up to $4 billion in FHLBank consolidated obligations under certain circumstances, *see* 12 U.S.C. § 1431(i), (*l*).

[11] *See Financial Institutions Reform, Recovery, and Enforcement Act of 1989*, Pub. L. No. 101-73, § 704, 103 Stat. 183, 415 (1989). These include banks whose deposits are insured by the Federal Deposit Insurance Corporation and credit unions whose shares are insured by the National Credit Union Administration. *See* 12 U.S.C. § 1422(9).

[12] *See Housing and Economic Recovery Act of 2008*, Pub. L. No. 110-289, § 1206, 122 Stat. 2654, 2787 (2008). CDFIs organized as a federally insured credit unions were eligible for FHLBank membership prior to 2008 based solely on their status as federally insured depository institutions.

[13] *See Fixing America's Surface Transportation Act*, Pub. L. No. 114-94, § 82001, 129 Stat. 1312, 1795 (2015).

The FHLBank Act also prescribes several additional requirements for FHLBank membership. Section 4(a)(1) of the FHLBank Act requires that an institution, regardless of type:

> (A) be duly organized under the laws of any state or the United States;
>
> (B) be subject to inspection and regulation under banking, or similar, laws of a state or the United States;[14] and
>
> (C) make such home mortgage loans as, in the judgment of FHFA, are long-term loans.[15]

An institution that fails to satisfy any of those requirements is not eligible for FHLBank membership.

Section 4(a)(2) of the FHLBank Act imposes additional eligibility requirements on insured depository institutions, requiring that each such institution:[16]

> (A) have at least 10 percent of its total assets in "residential mortgage loans";[17]
>
> (B) be in a financial condition such that advances may be safely made to it; and
>
> (C) show that the character of its management and its home-financing policy are consistent with sound and economical home financing.[18]

B. FHFA's Regulation on FHLBank Membership

FHFA's regulation on FHLBank membership specifies how and when an institution must demonstrate compliance with each of the statutory membership eligibility requirements, and otherwise implements those requirements. The regulation also establishes requirements relating to the membership application process, determination of the appropriate FHLBank district for membership, members' purchase and redemption of FHLBank capital stock, and voluntary or involuntary termination and reacquisition of membership.

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[14] In lieu of being subject to inspection and regulation by a state or federal regulator, a non-depository CDFI applicant must be certified as a CDFI by Treasury's CDFI Fund. *See* 12 U.S.C. § 1424(a)(1)(B).
[15] 12 U.S.C. § 1424(a)(1).
[16] The requirements of section 4(a)(2) apply only to insured depository institutions that became a member of a FHLBank after January 1, 1989.
[17] CFIs are exempt from the "10 percent" requirement. 12 U.S.C. § 1424(a)(4).
[18] 12 U.S.C. § 1424(a)(2).

Generally, the regulation groups FHLBank members and applicants into three categories: (1) federally insured depository institutions (including qualifying NFICUs); (2) insurance companies; and (3) non-depository CDFIs. The regulation requires each institution, regardless of type, to meet the same six general requirements in order to be considered eligible for membership, although the manner of determining compliance with those requirements may in some cases differ for different types of institutions under the regulation. Paralleling the statute, under the regulation an institution is eligible to be a FHLBank member only if:

(1) It is duly organized under tribal law, or under the laws of any state or of the United States (the "duly organized" requirement);

(2) It is subject to inspection and regulation under the banking laws, or under similar laws, of any state or of the United States (the "subject to inspection and regulation" requirement) or, in the case of a non-depository CDFI, is certified by the CDFI Fund;

(3) It makes long-term home mortgage loans (the "makes long-term home mortgage loans" requirement);

(4) Its financial condition is such that advances may be safely made to it (the "financial condition" requirement);

(5) The character of its management is consistent with sound and economical home financing (the "character of management" requirement); and

(6) Its home financing policy is consistent with sound and economical home financing (the "home financing policy" requirement).[19]

As explained above, the "duly organized," "subject to inspection and regulation," and "makes long-term home mortgage loans" requirements apply by statute to all types of institutions seeking FHLBank membership. The regulation extends the "financial condition," "character of management," and "home financing policy" requirements, which under the FHLBank Act apply only to depository institutions, to all institutions.

In addition to those six generally-applicable requirements, the regulation parallels the FHLBank Act by requiring that a non-CFI depository institution also have at least 10 percent of its total assets in residential mortgage loans in order to be eligible for membership (the "10 percent" requirement), but does not extend that requirement to CFIs, CDFIs, or insurance companies.[20] The regulation, however, does require institutions that are not insured depository institutions

[19] *See* 12 CFR 1263.6(a).
[20] *See* 12 CFR 1263.6(b).

(*i.e.*, non-depository CDFIs and insurance companies) to have "mortgage-related assets" that "reflect a commitment to housing finance," as determined by the FHLBank in its discretion, in order to be considered eligible.[21]

For each of the six general eligibility requirements, as well as the "10 percent" requirement, the regulation includes at least one separate section specifying in detail how a FHLBank is to determine whether an applicant for membership satisfies the requirement.[22] An applicant that meets the applicable criteria of any of those more detailed provisions is presumed to be in compliance with the corresponding eligibility requirement, although that presumption may be rebutted if the FHLBank obtains substantial evidence to the contrary.[23] Conversely, an applicant that does not meet the criteria of the more detailed regulatory provisions is presumed to be out of compliance with the corresponding eligibility requirement. With respect to the "subject to inspection and regulation," "financial condition," "character of management," and "home financing policy" requirements, the presumption of non-compliance can be rebutted if certain additional criteria are met.[24] The presumption of non-compliance arising from an applicant's failure to meet the criteria for the "duly organized," "makes long-term home mortgage loans," and "10 percent" requirements, however, is conclusive and may not be rebutted.

II. Safety and Soundness

The regulatory scheme under which the FHLBanks operate is designed to ensure that advances can safely and soundly be made to members—*i.e.*, to minimize the risk of loss on advances—and thus help to ensure that the FHLBanks will be able to provide liquidity to their members throughout the housing and business cycle. With respect to membership eligibility, the "financial condition" requirement addresses these concerns directly by providing that only an applicant whose financial condition is "such that advances may be safely made to it" may be admitted to membership. While all applicants are subject to the "financial condition" requirement, the information that a FHLBank must review in assessing a particular applicant's financial condition and the criteria that an applicant must meet to demonstrate compliance with

[21] *See* 12 CFR 1263.6(c). The regulation does not define the term "mortgage-related assets."
[22] *See* 12 CFR 1263.7-.18. In the case of the "financial condition" requirement, there are two such sections—one (§ 1263.11) setting forth the specific criteria for insured depository institutions and another (§ 1263.16) setting forth the specific criteria for insurance companies and CDFIs. There are also separate sections setting forth specific criteria for determining all of the eligibility requirements for recently chartered insured depository institutions (§ 1263.14) and for determining some of the eligibility requirements for recently consolidated institutions of any type (§ 1263.15).
[23] *See* 12 CFR 1263.17(a).
[24] *See* 12 CFR 1263.17(b) through (f).

the requirement may differ depending on whether the applicant is a depository institution, an insurance company, or a non-depository CDFI. These differences are intended to account for the distinct business models of those types of entities, their different risk profiles, and the different regulatory regimes under which they operate.

For example, a FHLBank must review financial statements for the prior three years for insured depository institution and CDFI applicants, yet need only review financial statements for the prior year for insurance company applicants (for CDFIs, only the prior year's financial statements are required to be audited). And, while both depository institutions and insurance companies must meet their applicable minimum regulatory capital requirements, only depository institution applicants must attain a specified minimum examination rating and meet specific financial metrics to be deemed to meet the financial condition requirement.

The "subject to inspection and regulation" eligibility requirement, which applies to all applicants except non-depository CDFIs, also helps to ensure that after a FHLBank has admitted an applicant to membership it will be able to extend credit to that institution on a safe and sound basis. An institution that is subject to a supervisory regime of prudential regulation is, other things being equal, more likely to be in a sound financial condition than one that is not, given the statutory regimes under which they operate and the incentives that their primary regulators (both banking and insurance) have to forestall the failure of the institutions they regulate. Similarly, by having ongoing access to the federal banking agencies' assessments of their regulated entities' financial condition, the FHLBanks can validate identified and increasing credit risk concerns or discover other risks at an earlier stage when they can take actions to strengthen the control of collateral.[25] Moreover, when an insured depository institution member fails, a FHLBank's claims against that member are typically resolved expeditiously under well-understood receivership processes administered by the Federal Deposit Insurance Corporation (FDIC) or National Credit Union Administration (NCUA). For members that are not subject to federal or state inspection and regulation, such as non-depository CDFIs, a FHLBank's claims against such a failed member likely would be subject to the federal bankruptcy laws, which introduce greater risks regarding timely repayment of amounts owed to the FHLBank.

In addition to the membership eligibility requirements, the applicable statutes and regulations governing FHLBank advances include several other requirements designed to ensure that the FHLBanks extend credit to their members in a safe and sound manner. Under those provisions,

[25] The FHLBanks have a statutory right to receive from federal financial regulators any information that may be available relating to the condition of any member or applicant. *See* 12 U.S.C. § 1442(a). The FHLBanks' ability to obtain information on the condition of insurance company members and applicants from their state regulators is governed by state law and varies from state to state.

all advances must be fully secured by specified collateral—primarily residential mortgage loans and securities backed by such loans, securities issued, insured or guaranteed by the United States or any agency thereof, other real estate-related collateral meeting certain requirements, and cash.[26] A FHLBank may limit or deny a member's application for an advance if, based on the FHLBank's credit underwriting, it determines that it may not safely make an advance to the member.[27] By statute, any security interest granted to a FHLBank by a member or affiliate of a member is entitled to priority over the claims and rights of nearly all other parties.[28] As a matter of practice, when an insured depository institution is placed into receivership, all outstanding advances typically have been repaid by the FDIC or NCUA, avoiding the need for the FHLBank to liquidate the collateral.

III. The Mission of the FHLBanks

FHFA regulations define the mission of the FHLBanks as providing to their members and housing associates financial products and services that assist the financing of housing and community lending.[29] This definition was originally adopted by the former Federal Housing Finance Board and was re-adopted by FHFA in 2010.[30] It remains consistent with both the FHLBank Act and the Federal Housing Enterprises Financial Safety and Soundness Act (Safety and Soundness Act), under which FHFA is established. Read together, these statutes clearly evidence a Congressional view that the FHLBanks have a housing finance and community development mission and that it is the duty of the Director of FHFA to ensure that the FHLBanks carry out that mission.

The Safety and Soundness Act, for example, includes among the duties of the Director of FHFA a responsibility to ensure that the operations and activities of the FHLBanks foster liquid, efficient, competitive, and resilient national housing finance markets and that they carry out their statutory mission through activities that are authorized under the FHLBank Act.[31] Similarly, the advances and membership provisions of the FHLBank Act indicate the scope of that mission, stating that a FHLBank may make long-term advances to members only for the purposes of providing funds for residential housing finance and, in the case of CFIs, providing funds for small businesses, small farms, small agri-businesses, and community development activities.[32]

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[26] *See* 12 U.S.C. § 1430(a); 12 CFR 1266.7(a).
[27] *See* 12 U.S.C. § 1429; 12 CFR 1266.4(a).
[28] *See* 12 U.S.C. § 1430(e).
[29] *See* 12 CFR 1265.2.
[30] *See* 75 Fed. Reg. 8240 (Feb. 24, 2010).
[31] *See* 12 U.S.C. § 4513(a)(1).
[32] *See* 12 U.S.C. § 1430(a)(2).

In addition, the FHLBanks' mission is reflected in the statutory provisions that limit the types of collateral that they may accept for advances to members, which include, in addition to cash and government securities, first mortgage loans on residential property and securities representing a whole interest in such mortgage loans, as well as other real estate related collateral (and, in the case of any CFI, secured loans for small business, agriculture, or community development activities or securities representing a whole interest in such secured loans).[33]

The FHLBank Act's membership provisions reinforce the connection between eligibility for membership and the FHLBanks' housing finance and community development mission by requiring all eligible applicants to satisfy the "makes long-term home mortgage loans" requirement, by requiring all insured depository institution applicants to meet the "home financing policy" requirement, and by requiring all non-CFI depository institution applicants to meet the "10 percent" requirement in order to become a member. As mentioned above, FHFA's regulation on FHLBank membership extends the "home financing policy" requirement to all FHLBank members.

In addition to considering safety and soundness, FHFA's current membership review aims to ensure that the FHLBank membership regulation remains consistent with the above-described statutory requirements, and with the housing finance and community development mission underlying those requirements. Specifically, this review seeks to determine what standards might best ensure that institutions admitted to membership or receiving FHLBank funding demonstrate a sufficient commitment to housing finance and community and economic development and otherwise comply with applicable statutory requirements.

As mentioned, three eligibility requirements link membership to housing finance: the "10 percent" requirement, the "makes long-term home mortgage loans" requirement, and the "home financing policy" requirement. Under the regulation, compliance with these requirements need only be demonstrated during the membership application process, and never thereafter. In developing the 2016 final rule, the FHFA considered whether the mission of the FHLBanks would be materially advanced if FHLBank members were to be required to demonstrate compliance with any or all of those housing finance-related requirements on an ongoing basis, as opposed to merely at the time of application. FHFA also considered whether members should be required to have a written home financing policy and whether it should establish by regulation a minimum level of home mortgage loans that must be held to be in compliance with the "makes long-term home mortgage loans" requirement. Under the regulation, holding even one mortgage

[33] *See* 12 U.S.C. § 1430(a)(3).

loan or one mortgage-backed security would arguably be sufficient for an applicant to meet the requirement. In the final rule, the FHFA did not make any of those changes to the regulation.

IV. The Use of Conduits by Ineligible Entities to Obtain Access to FHLBank Funding

Because the market advantages conferred upon the FHLBanks allow them to pass on low-cost funds to their members, FHLBank membership can be an attractive proposition, especially to entities seeking long-term funding to originate or acquire residential mortgage loans or securities backed by such loans. In the several years prior to 2016, numerous real estate investment trusts (REITs) and similar mortgage and real estate-related investment funds that were not eligible for FHLBank membership on their own were able to achieve a form of *de facto* membership by establishing small captive insurance subsidiaries that became FHLBank members (as permitted under the regulatory regime existing at that time) for the purpose of accessing low-cost FHLBank advances to fund the parents' operations. The levels of advances taken down by many of these captive members were disproportionately large in comparison with the investments and insurance underwriting operations of the captives themselves, and many of the parent companies were guaranteeing repayment of the advances made to their captive subsidiaries and providing the collateral for those advances.[34] Most of the parents that received indirect FHLBank funding through those captive insurance subsidiaries were not themselves subject to inspection and regulation by federal or state banking regulators or by state insurance regulators.

FHFA viewed the enumeration in statute of the specific types of institutions eligible for FHLBank membership as an indication by Congress that institutions not explicitly authorized for membership could neither become members directly, nor do so indirectly through conduit arrangements, regardless of the extent to which they may be engaged in some part of the residential mortgage market. FHFA concluded that the use of a captive insurance company as a conduit to obtain FHLBank funding for an ineligible parent company constituted a circumvention of the statutory membership eligibility requirements. Thus, the 2016 final rule effectively prohibited captive insurance companies from being FHLBank members.

[34] FHFA's current regulation on FHLBank advances permits member advances to be secured, without limit, by eligible assets held by an affiliate, provided: (1) the collateral is pledged to secure either the member's obligation or an agreement under which the affiliate has assumed a primary obligation to repay along with the member; and (2) the FHLBank obtains and maintains a legally enforceable security interest pursuant to which the its legal rights and privileges with respect to the collateral are functionally equivalent in all material respects to those that the FHLBank would possess if the member were to pledge the same collateral directly. *See* 12 CFR 1266.7(g).

The rule barred from membership most captives and similar types of limited-purpose insurers (regardless of whether they are chartered under the captive insurance laws of a state) that, because of their lower set-up and operating costs and lighter regulatory burdens, are especially susceptible to being used as conduit entities.[35] The final rule made captive insurance companies ineligible for membership, but permitted any captive that had been admitted to membership prior to the publication date of the proposed rule to retain its membership for five years following the effective date of the final rule (that is, to February 19, 2021).[36] The rule required the FHLBanks to terminate by February 19, 2017 the membership of the approximately 38 captives that became members after the publication date of the proposed rule.[37]

Subsequent to that rulemaking, entities ineligible for membership have attempted to establish other types of conduit arrangements to gain access to the System, such as through for-profit and other non-depository CDFIs and, to a lesser extent, through special purpose banks (that is, FDIC-insured institutions the deposits of which are obtained principally or exclusively from affiliates, and that conduct little or no retail lending or deposit taking from the general public), none of which fall within the definition of "captive" established under the 2016 rulemaking. To date, FHFA has addressed such situations on a case-by-case basis and has not initiated a rulemaking to prevent the use of these other types conduit arrangements, in part because most of the newly established conduit entities did not satisfy all of the applicable requirements for membership—particularly the "financial condition" requirement— and therefore were not able to become members.

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[35] Specifically, the final rule added to the membership regulation a definition of "insurance company," defining that term to mean "a company whose primary business is the underwriting of insurance for nonaffiliated persons or entities." The rule defined "captive" to mean "an entity that holds an insurance license or charter under the laws of a State, but that does not meet the definition of 'insurance company' set forth in [the regulation] or fall within any other category of institution that may be eligible for membership." *See* 81 Fed Reg. 3246, 3278-79. Thus, while these definitions were intended to separate insurance entities that are susceptible to use as conduits (which are designated as "captives" under the regulation) from those that are less susceptible to such use, the distinction does not actually depend upon whether the entity is chartered under the captive insurance laws of a state. A typical captive, however, whose primary business is the underwriting of insurance for its parent company or for other affiliates, does not fall within the scope of the definition of "insurance company" and therefore is not eligible for FHLBank membership as an "insurance company" under the regulation, as amended.

[36] *See* 12 CFR 1263.6(e)(1).

[37] *See* 12 CFR 1263.6(e)(2).

Questions and Public Input Instructions

FHFA invites comments on all aspects of this RFI and issues related to FHLBank membership. FHFA considers the questions set forth below to be important to its understanding of the safety and soundness and mission implications of both the current membership requirements and any potential future changes.

FHFA invites interested parties to provide written comments on the questions listed below, no later than June 23, 2020. Comments should be submitted electronically using the response form at https://www.fhfa.gov/AboutUs/Contact/Pages/Request-for-Information-Form.aspx (select "FHLBank Membership" in pull down) or via mail to the Federal Housing Finance Agency, Division of Federal Home Loan Bank Regulation, 400 7th Street SW, 7th Floor, Washington, D.C. 20219. Generally, all comments received will be made public and posted without changes to FHFA's website. However, if you wish for FHFA to consider any portion of your response exempt from disclosure, please put that portion in a separate attachment and clearly mark it "confidential commercial information." The procedures for identifying "confidential commercial information" can be found in FHFA regulations at 12 CFR 1202.8, available on FHFA's website.

1. ***General***. FHFA seeks to develop requirements to address questions regarding membership eligibility on a consistent basis, guided by the twin objectives of ensuring that the System remains safe and sound and able to provide liquidity for housing finance through the housing and business cycle and ensuring that all members have an appropriate nexus to the housing finance and community development mission of the FHLBanks.

    a) In addition to the statutory requirements of the FHLBank Act, what are the most important general principles and factors FHFA should consider in achieving those objectives?

    b) Are there classes or types of institution not currently eligible for FHLBank membership under FHFA's current regulation whose eligibility would simultaneously further both of those objectives and, if so, how? In particular:

        i. What would be the safety and soundness risks, if any, to the FHLBanks or the System of making such institutions eligible for membership? What impacts, if any, would allowing such institutions to be members have on the System's cost of funds and ability to provide low-cost liquidity to current members?

ii. How, specifically, would membership of such institutions further the housing finance and community development mission of the FHLBanks?

iii. Would allowing such institutions to be members further FHFA's duty to ensure that the operations and activities of the FHLBanks foster liquid, efficient, competitive, and resilient national housing finance markets? How would doing so affect competition among existing participants in housing finance markets? How would doing so improve the System's resiliency through the cycle? Please be specific.

2. ***Financial condition requirement***. As described above, the provisions of the current regulation implementing the "financial condition" eligibility requirement establish different standards of review for different types of eligible entities.

   a) In general, what financial factors should FHFA consider for the types of entities eligible for membership, and how many years of financial statements and other data is sufficient for a FHLBank to make a sound assessment of an applicant's financial condition?

   b) Would there be benefits to establishing financial condition review requirements that are substantially similar for all applicants, regardless of whether they are organized as an insured depository institution, insurance company, or CDFI? What would such requirements comprise, and would such changes entail risks to the System's safety and soundness and the FHLBanks' ability to provide liquidity to members through the cycle?

3. ***Use of conduit arrangements by ineligible entities***.

   a) Should FHFA amend its regulations to bar from FHLBank membership particular types of otherwise-eligible entities that are most susceptible to being used as conduit vehicles by institutions that are not themselves eligible for membership? Which types of currently eligible entities are most susceptible to such use?

   b) How should FHFA balance the legitimate housing finance activities of those types of entities against the risks that they could be misused as funding conduits by ineligible entities to create another form of *de facto* membership?

   c) Should FHFA amend its regulations to impose conditions on membership approvals pertaining to those entities that are susceptible to being used as conduits that do not apply to other types of members?

d) Irrespective of membership requirements, should FHFA limit conduit activity by FHLBank members through other means, such as by restricting the amount of advances a FHLBank may have outstanding to a single member (for example, to a percentage of the member's total assets) or limiting the extent to which affiliates may pledge collateral to secure a member's advances? If so, what should those limitations be? Should FHFA impose any such limitations on all FHLBank members as a prudential measure, irrespective of any concerns about conduit activity?

4. ***Unsupervised members and affiliates***.

a) What are the principal risks to the FHLBanks from doing business with members that are not subject to supervision by a prudential safety and soundness regulator, and are those risks materially greater than those associated with doing business with members subject to such oversight?

b) If FHFA were to allow conduit arrangements, what would be the principal risks to the FHLBanks in cases where the affiliate to which the FHLBank funding is being passed by the conduit member is not subject to supervision by a prudential safety and soundness regulator?

c) To the extent there are added risks arising from either scenario, what measures could FHFA or the FHLBanks take (for example, enhanced collateral discounts, capital requirements, or other counterparty risk management practices) that would best mitigate those risks? Would such measures be sufficient? Please be as specific as possible.

d) What would be the added risks and costs, if any, to the FHLBanks and the System, including with respect to the cost of funds, in the event of a default or failure of a member and/or parent institution for which a bankruptcy or similar proceeding would be the resolution regime (as opposed, for example, to an FDIC resolution for an insured depository institution)?

5. ***Nexus to FHLBanks' public policy mission***.

a) Is the current membership regulation sufficient to ensure that the activities of FHLBank members have a sufficient nexus to the public policy mission of the FHLBanks? If not, what changes should be made?

b) Should FHFA require FHLBank members to demonstrate an ongoing commitment to housing finance in order to remain eligible for membership? If so, how should that commitment be measured and monitored?

c) If FHFA were to permit conduit arrangements, should it limit such arrangements to members whose parent company is actively and substantially engaged in activities that are consistent with the housing finance and community development mission of the FHLBanks? If so, what criteria should be employed and how could compliance with such criteria be monitored and enforced?

d) Would the use of FHLBank advances to finance the purchase of mortgage-backed securities by the conduit entity or its parent, as was the case with mortgage REITs that created captive insurance companies, be consistent with the mission of the FHLBanks, particularly if the mortgage-backed securities have been issued or guaranteed by Fannie Mae or Freddie Mac?

6. ***Rebuttable presumption approach of regulation***. As discussed above, an applicant's failure to meet the specific standards by which compliance with a membership eligibility requirement is determined may, in some cases (specifically, with respect to the "subject to inspection and regulation," "financial condition," "character of management," and "home financing policy" requirements), raise a mere presumption of non-compliance that the applicant may rebut by meeting additional criteria. The intent behind this approach is to facilitate the processing of membership applications by the FHLBanks by allowing them to exercise a degree of judgment in assessing the unique facts that may be presented by some applicants. Because those additional criteria allow the FHLBanks considerably more discretion than do the primary standards, however, they also are more subject to misinterpretation and misapplication, particularly when the FHLBanks are considering cases of first impression.

   Would the safety and soundness of the FHLBanks be enhanced if FHFA were to establish new standards that provided less discretion to the FHLBanks, and all of which must be met for an applicant to be admitted to membership? If so, what should those standards be? Please explain in detail.

7. ***Other issues and concerns***. Are there any issues not explicitly discussed above that relate to FHLBank membership and need clarification?