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June 23, 2020

Mr. Andre D. Galeano, Deputy Director  
Federal Housing Finance Agency  
Division of Federal Home Loan Bank Regulation  
400 7th Street, NW, 7th Floor  
Washington, DC 20219

**RE: ICBA Comments on FHFA’s Request for Input on FHLB Membership**

Dear Deputy Director Galeano:

The Independent Community Bankers of America (ICBA)<sup>1</sup> welcomes the opportunity to provide comments on a Request for Input (RFI) from the Federal Housing Finance Agency (FHFA) regarding Federal Home Loan Bank (FHLB) Membership. ICBA appreciates FHFA’s continued dedication to maintaining a FHLB system that is safe, sound, and provides liquidity for housing finance throughout the housing and business cycle.

The FHLB system - comprised of 11 federal home loan district banks cooperatively owned by more than 7,000 depository institutions - is regulated by FHFA to preserve the safe, steady, and affordable source of liquidity for local residential housing throughout the United States. Approximately 98% of ICBA members belong to a FHLB. Community banks depend on FHLBs for liquidity, asset/liability management, and match funding for longer term loans. It is therefore crucial that the FHLBs and their regulator adhere to a membership policy that does not introduce unnecessary risks that could jeopardize the FHLBs’ purpose and mission.

**Background**

FHFA has the authority and duty to implement the statutory membership provisions of the Federal Home Loan Bank Act (FHLBank Act) and the Federal Housing Enterprises Financial Safety and Soundness Act (Safety and Soundness Act). Consistent with its statutory authority, FHFA regulations broadly frame the mission and purpose of the FHLBs as entities that supply their members with affordable and reliable

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<sup>1</sup> *The Independent Community Bankers of America® creates and promotes an environment where community banks flourish. With more than 50,000 locations nationwide, community banks constitute 99 percent of all banks, employ nearly 750,000 Americans and are the only physical banking presence in one in three U.S. counties. Holding more than \$5 trillion in assets, more than \$4 trillion in deposits, and more than \$3.4 trillion in loans to consumers, small businesses and the agricultural community, community banks channel local deposits into the Main Streets and neighborhoods they serve, spurring job creation, fostering innovation and fueling their customers’ dreams in communities throughout America. ICBA is dedicated exclusively to representing the interests of the community banking industry and its membership through effective advocacy, best-in-class education, and high-quality products and services.*

advances that bolster housing and community lending. FHFA is also responsible for monitoring the operations of the FHLBs so they adhere to their statutory mission and scope while continuing to help maintain liquid and robust national housing finance markets.

In a 2016 Final Rule, FHFA addressed and updated FHLB membership criteria. Several years leading up to that regulation, FHFA and other stakeholders grew increasingly concerned as ineligible entities gained access to FHLB funding through the acquisition or formation of captive insurance companies. FHFA's 2016 Final Rule addressed these concerns by stating that captive insurance companies are not considered eligible to be members of the FHLB system and need to exit the system by 2021. This tactic of using captives as conduits for FHLB funding allows real estate investment trusts (REITs) and other underregulated non-bank entities backdoor access to low-cost funding. This practice has continued in some FHLB districts since the 2016 Final Rule and has become one of the primary reasons that FHFA has revisited the FHLB membership issue with this RFI. In addition to the safety and soundness concerns, FHFA's rationale for making captive insurance companies ineligible for FHLB membership was that Congress had effectively enumerated the specific types of financial institutions allowed access – whether direct or indirect via a conduit – to FHLB funding, and therefore Congress would need to revise the statute for captive insurance companies to be eligible for membership.

The 2016 Final Rule contemplated reconfiguring eligibility requirements and membership provisions to better align them with the FHLBs' mission. As mandated by the FHLBank Act, members are required to meet certain criteria, and the accompanying regulation established the specific ways in which an institution may sufficiently demonstrate compliance. Among the most important of the regulatory requirements are: subjection to regulation and inspection by state or federal banking laws; the origination of long-term home mortgage loans; evidence of sound and economical home finance policy; significant mortgage-related assets indicating a commitment to housing finance – applicable only to institutions like Community Development Financial Institutions (CDFIs) that are not insured depositories; and requiring that, with the exception of community financial institutions (CFIs), CDFIs, and insurance companies, a depository institution must have 10 percent of its total assets in residential mortgage loans in order to be eligible for membership.

Additionally, regulation established that compliance with the 10 percent requirement, as well as originating long-term home loans and sound home financing policy only had to be demonstrated during the membership application process. FHFA considered making these requirements on-going and potentially setting a minimum level of portfolio mortgage loans. ICBA strongly opposed subjecting current community bank members to an ongoing membership test.<sup>2</sup> We were pleased that the 2016 Final Rule did not follow through with these changes.

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<sup>2</sup> [https://www.icba.org/docs/default-source/icba/news-documents/press-release/2016/cl010615.pdf?sfvrsn=5c019f08\\_2](https://www.icba.org/docs/default-source/icba/news-documents/press-release/2016/cl010615.pdf?sfvrsn=5c019f08_2)

## **Response**

ICBA appreciates FHFA's thoughtful and holistic approach to updating FHLB membership rules and criteria. Establishing a set of transparent and broadly applicable principles – rooted in safety and soundness – that clarify and update existing regulation is a laudable goal. However, ICBA would like to emphasize several key points going forward.

It is critical that regulatory actions made by FHFA do not lose sight of the statutorily defined mission that has served FHLBs so well for decades. It is of paramount importance that any change to FHLB membership does not inadvertently create market uncertainty or undermine the FHLBs' uniquely advantageous position to provide low-cost capital with little to no risk. This reliability and consistency are significant reasons why community banks of all sizes utilize and effectively leverage FHLB funding to invest in their communities during all market conditions. Regulatory actions should therefore not jeopardize this reputation, nor should they introduce unnecessary risk that undermines confidence in the FHLB System.

The prospect of unregulated institutions gaining access to FHLB advances represents significant risks to the safety and soundness of the FHLB System. To the extent that any additional class of entities are allowed access to the System, any regulatory change should be preceded by a public and transparent process, done in collaboration with Congress and FHFA, allowing for debate about the safety and soundness implications. Presently, without explicit authorization in statute, ineligible institutions should not be permitted to become members. It would be especially problematic if they are permitted to circumvent the intent of Congress and FHFA through a conduit. The captive insurance restrictions from the 2016 Final Rule remain a contentious issue, and it is likely to be magnified as the present economic challenges due to the COVID-19 pandemic play out.

Additionally, FHFA should avoid membership criteria that could disincentivize or prevent community banks from becoming or remaining as long-term members. The RFI, for example, considers implementing more stringent ongoing membership requirements on top of the initial requirement during the application process. ICBA strongly opposes any ongoing membership test for depository institutions. This would stretch FHFA's legal authority by contradicting language in the FHLBank Act. More concerning is the prospect of FHFA arbitrarily setting a minimum level of portfolio residential mortgage loans – perhaps comparable to the 10% requirement from which many community banks are exempt – that must be maintained. This would prove especially onerous for smaller community banks. Community banks are constantly adapting to the needs of their local customers. Smaller banks, typically in rural areas, depend on low-cost FHLB funding not just for mortgage loans – they also benefit from advances that allow them to make small business loans or small farm loans. Moreover, smaller community banks may not necessarily have the volume or capacity to keep mortgage loans on their books for extended periods.

## **Conclusion**

ICBA applauds FHFA for taking this thoughtful, reasoned approach to reforming the FHLBs' membership requirements. We appreciate the chance to communicate to FHFA the importance of insulating the FHLBs from entities that could potentially harm the risk profile of the entire system. Community banks are highly engaged on this issue because they are partial owners within the cooperative and greatly benefit from the funding FHLBs provide. Please contact the undersigned at [ron.haynie@icba.org](mailto:ron.haynie@icba.org) regarding any questions you may have regarding our comments.

Sincerely,

/s/

Ron Haynie

Senior Vice President, Mortgage Finance Policy

*The Nation's Voice for Community Banks.*<sup>®</sup>

WASHINGTON, DC  
1615 L Street NW  
Suite 900  
Washington, DC 20036

SAUK CENTRE, MN  
518 Lincoln Road  
P.O. Box 267  
Sauk Centre, MN 56378

866-843-4222  
[www.icba.org](http://www.icba.org)