



MORTGAGE BANKERS ASSOCIATION

June 23, 2020

The Honorable Mark Calabria
Director
Federal Housing Finance Agency
400 7th Street, SW
Washington, DC 20219

RE: Federal Home Loan Bank Membership – Request for Input

Dear Director Calabria:

The Mortgage Bankers Association (MBA)¹ appreciates the opportunity to provide observations and recommendations on the Federal Housing Finance Agency (FHFA) Request for Input (RFI) regarding Federal Home Loan Bank (FHLB) membership.² MBA has long supported the responsible expansion of FHLB membership eligibility to better reflect the diverse providers of single-family and multifamily housing finance throughout the country. Any such expansion should be undertaken in a manner that promotes safety and soundness through appropriate risk management practices and counterparty oversight.

Specifically, MBA recommends that FHFA amend its 2016 rulemaking³ with respect to FHLB membership eligibility to revise the definition of eligible insurance companies, while also developing a comprehensive framework to set the minimum requirements for eligible captive insurers. These amendments to the existing regulations would provide a clear path to FHLB membership for captive insurers that are affiliated with well-managed, financially stable institutions that are primarily engaged in housing finance.

¹ The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, DC, the association works to ensure the continued strength of the nation's residential and commercial real estate markets, to expand homeownership, and to extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,100 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, credit unions, thrifts, REITs, Wall Street conduits, life insurance companies, and others in the mortgage lending field. For additional information, visit MBA's website: www.mba.org.

² FHFA, "Federal Home Loan Bank Membership – Request for Input," February 24, 2020. Available at: <https://www.fhfa.gov/Media/PublicAffairs/PublicAffairsDocuments/RFI-on-FHLBank-Membership.pdf>.

³ 81 FR 3246.

The development of a membership eligibility framework for captive insurers would carry numerous benefits for the FHLBs and the broader housing finance system. Such a framework, if implemented effectively, would ensure that FHLB advances are only available to institutions that are aligned with the mission of the FHLB System. It would also create a more level regulatory construct by reducing disparities based on institutions' charters. Indeed, rather than open a "back door" for FHLB membership, FHFA should clearly and transparently define the minimum requirements for captive insurer affiliates, which would provide direction to the FHLBs as they evaluate new applicants. Finally, a well-crafted framework would strengthen the broader housing finance system by increasing the supply of reliable, longer-term liquidity to institutions that play critical roles in this system.

The comments below are organized as follows:

- Part I – General Comments
- Part II – Framework for Membership Eligibility
- Part III – Application to Mortgage Real Estate Investment Trusts (REITs)
- Part IV – Application to Independent Mortgage Banks (IMBs)

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Part I – General Comments

Objectives of the System

MBA fully supports FHFA’s consideration of “the twin objectives of ensuring that the [FHLB] System remains safe and sound...and ensuring that all members have an appropriate nexus to the housing finance and community development mission of the [FHLBs]” in assessing potential amendments to the FHLB membership regulation.⁴ Any framework for membership eligibility must ensure that each of these objectives is met when new institutions are provided access to the System.

With respect to safety and soundness, the FHLBs have a remarkable track record of success, having never incurred a loss on an advance in their nearly 90-year history.⁵ The Council of Federal Home Loan Banks attributes this stability to several factors, including conservative underwriting standards and investment practices, strong credit monitoring policies, the collateralization of advances, acceptance of high-quality collateral, activity-based stock purchase requirements that are commensurate with borrowing levels, and the joint and several liability for aggregate obligations in the System.⁶ These positive features of the System should remain in place through any amendments to the membership regulation.

Similarly, the mission of the FHLBs derives from their origin in the FHLB Act, which was enacted during the Great Depression. The creation of the FHLBs led to greater liquidity for financial institutions for the purpose of originating residential mortgages. Today, the FHLBs’ mission continues to be to “provide reliable liquidity to member institutions to support housing finance and community investment.”⁷ Any new entrant to the System should further this mission, which would allow the FHLBs to contribute to a more robust housing finance system while also ensuring that FHLB advances are not used by institutions that do not align with the FHLBs’ statutory purposes.

Benefits of Diverse FHLB Membership

One of the primary strengths of the U.S. housing finance system is the diverse nature of its providers of capital, financing, and origination and servicing activity. These functions are performed by depository and non-depository institutions of vastly differing sizes and business models, as well as both domestic and foreign investors.

⁴ FHFA, “Federal Home Loan Bank Membership – Request for Input,” February 24, 2020. Available at: <https://www.fhfa.gov/Media/PublicAffairs/PublicAffairsDocuments/RFI-on-FHLBank-Membership.pdf>.

⁵ Council of Federal Home Loan Banks, “Safety and Soundness.” Available at: <https://fhlbanks.com/safety-and-soundness/>.

⁶ Ibid.

⁷ Council of Federal Home Loan Banks, “Mission.” Available at: <https://fhlbanks.com/mission/>.

This diversity generates stronger market competition and produces tangible benefits for consumers in the form of greater choice, lower pricing, and more favorable loan terms.

The set of institutions eligible for direct FHLB membership partially represents this diversity. The FHLB Act, as amended, provides membership eligibility for various types of banks, credit unions, insurance companies, and community development financial institutions, among others.⁸ This structure recognizes the broad range of housing finance providers throughout the country, but it also falls short of reflecting the full scope of institutions that currently play critical roles as lenders, servicers, and investors.

A more diverse FHLB membership base would enhance many of the consumer benefits noted above. The FHLBs could leverage their roles as providers of liquidity to strengthen the single-family and multifamily housing finance and community investment activities of a broader set of institutions, expanding access to credit on affordable terms for borrowers.

A broader membership base would allow the FHLBs to better achieve their mission, as well. The share of residential mortgage originations by FHLB-eligible institutions has declined over the past decade, thereby reducing the role of the FHLBs in providing liquidity relative to the size of the market. A responsible expansion of membership eligibility to other non-depository institutions could reverse this trend, making the FHLBs more effective providers of liquidity across the market.

Increased diversity in eligible members also would carry benefits for the FHLBs. New classes of members would increase demand for advances and other FHLB offerings, thereby increasing FHLB earnings while also reducing concentration in advances to any particular type of institution. Much as diversity in market participants bolsters stability for the housing finance system in the aggregate, such diversity would have a similar effect on the stability of the FHLB System.

Eligibility of Captive Insurers

In the RFI, FHFA notes that several institutions not otherwise eligible for direct FHLB membership established captive insurers that became FHLB members in the years preceding its 2016 rulemaking on membership eligibility. This rule effectively prohibited captive insurers from obtaining or maintaining FHLB membership, finding that it was inappropriate for ineligible institutions to use captive insurers as a means to access FHLB advances.

⁸ 12 U.S.C. §1424(a)(1).

Many of the concerns expressed regarding the use of captive insurers revolved around the regulatory and supervisory framework under which they operate, as well as the scale of their activities focused on housing finance or community investment. These concerns can and should be addressed in any potential amendments to the membership regulation. MBA believes the most logical way to address these concerns is for FHFA to apply any assessments of eligibility (e.g., its consideration of nexus to mission and safety and soundness) to the parent company or affiliate of the captive insurer.⁹ Similarly, any individual FHLB could also undertake due diligence reviews of the full corporate structure of the institution, including the parent or affiliate as well as the captive insurer.

While MBA believes captive insurers should be deemed eligible for FHLB membership based on the clear language of the FHLB Act and an analysis of Congressional intent (as is discussed below), MBA also recognizes that FHFA and the FHLBs need to ensure that membership is not used in ways that dilute the mission of the System or threaten safety and soundness. By applying appropriate standards to the parent or affiliate of the captive insurer, FHFA and the FHLBs can evaluate membership by captive insurers in a manner that aligns with the FHLBs' mission and safety and soundness interests. Said differently, MBA believes that captive insurers should not be used to evade oversight or take advantage of differences in regulatory or supervisory frameworks.

The 2016 rule challenges the notion that captive insurers should fall under the definition of an “insurance company” that is eligible for FHLB membership under the terms of the FHLB Act. The FHLB Act, however, provides eligibility for “*any*...insurance company” (emphasis added), subject to the membership application process and corresponding due diligence by the relevant FHLB.¹⁰

FHFA has noted that captive insurers did not exist when the FHLB Act was enacted in 1932, arguing that such institutions could not have been contemplated by Congress at the time. The language referencing “any” insurance company, though, was included not only in the original version of the law enacted in 1932, but also was maintained by Congress when the FHLB Act's membership provisions were subsequently amended in 1989, 2008, and 2015 – decades after captive insurers were established and well-known to legislators, regulators, and financial market participants.

MBA believes that FHFA should adhere to the statutory language of the FHLB Act and not deny FHLB membership eligibility to insurance companies solely due to the

⁹ Throughout these comments, the terms “parent” or “affiliate” will be used to indicate the entity that is the guarantor with respect to any advances made to the captive insurer member.

¹⁰ 12 U.S.C. §1424(a)(1).

type of insurance offered by those companies or their affiliation with their customers. As such, it should rescind the regulations contained in 12 C.F.R. §1263.6(e), and other conforming changes should be made throughout 12 C.F.R. Part 1263 to reverse the effects of the portions of FHFA’s 2016 rule pertaining to captive insurers. With respect to the parameters of membership eligibility, FHFA should apply mission and safety and soundness requirements to the parent or affiliate of any captive insurer member.

Current Non-Captive Insurer FHLB Members

The RFI poses questions related to the membership eligibility of, or potential requirements that could be imposed on, current FHLB members (those that maintain direct membership rather than membership through a captive insurer). MBA does not believe that any changes to FHFA’s existing membership framework are needed with respect to these current FHLB members.

System-wide limits on advances to particular institutions or types of institutions, for example, could have negative impacts or unintended consequences on both the FHLB member as well as the FHLB itself. Because each situation with a particular member or a particular FHLB is unique (e.g., the use of advances by the member and the distribution of advances by the FHLB), it would not be appropriate for FHFA to institute “across-the-board” limits.

Similarly, requirements that result in an ongoing analysis of current non-captive insurer members’ commitment to housing finance would likely generate costs that significantly outweigh their benefits. MBA is not aware of widespread (and direct) access to FHLB advances by institutions that do not participate in the housing finance system. As such, it is not clear there is a problem that this type of increased reporting and evaluation burden would be intended to solve. If there are discrete cases in which FHFA or an FHLB has reason to be concerned about a member’s ongoing commitment to housing finance, the FHLB should work directly with that institution and make use of the tools at its disposal to appropriately address the situation.

Part II – Framework for Membership Eligibility

General Application of the Framework

In order to evaluate the eligibility of a parent or affiliate of a captive insurer applying for FHLB membership, FHFA should develop a framework that includes minimum requirements related to both mission and safety and soundness. MBA believes that FHFA’s role should be to set these minimum requirements for eligibility, while the ultimate decision regarding an institution’s application should be determined by the

relevant FHLB. Such an approach would mirror the existing FHLB membership model for other types of institutions. It would also align with FHFA’s role in setting minimum net worth, capital, and liquidity standards for non-depository institutions that are Fannie Mae- or Freddie Mac-approved servicers.

MBA believes that a robust framework would be one that is broadly applicable to any type of institution that obtains access to FHLB advances through a captive insurer. While the general parameters and factors analyzed should apply evenly, some of the specific metrics or thresholds may need to be tailored to institution type. The lone exception to this construct involves situations in which an institution that is eligible for direct membership obtains FHLB membership through a captive insurer. In these cases, the parent or affiliate should be evaluated through the same criteria that would be used if the institution were applying for direct membership. (In other words, the framework for captive insurers should not be used.)¹¹

The remainder of this section details MBA’s recommendations for the parameters of this framework, which should apply to any parent or affiliate inasmuch as the parent or affiliate will be part of the FHLB’s overall due diligence evaluation and will likely be pledging collateral, guaranteeing advances, or benefiting from advances.

Nexus to the FHLBs’ Mission

The FHLB Act requires that, to become eligible for FHLB membership, an institution must “make such home mortgage loans as, in the judgment of the [FHFA] Director, are long-term loans...”¹² The FHLB membership regulation requires that, to provide evidence of this activity, an institution must show in its most recent regulatory financial report that it “originates or purchases long-term home mortgage loans,”¹³ where “long-term” loans are deemed to be those with “a term to maturity of five years or greater at the time of origination.”¹⁴

The FHLB membership regulation further specifies that applicants must have “a home financing policy [that] is consistent with sound and economical home financing”

¹¹ For instance, in situations in which a captive insurer is a subsidiary of a bank holding company or an insured depository institution, it would be appropriate to evaluate FHLB membership eligibility in light of this corporate structure rather than through the framework for captive insurers provided herein. Existing captive insurer members in these situations should be allowed to retain their FHLB membership without the need to re-apply or otherwise change the terms or conditions of their membership.

¹² 12 U.S.C. §1424(a)(1)(C).

¹³ 12 C.F.R. §1263.9.

¹⁴ 12 C.F.R. §1263.1.

and “consistent with the [FHLB] System’s housing finance mission”¹⁵ and that non-depository institutions “must have mortgage-related assets that reflect a commitment to housing finance, as determined by the [FHLB] in its discretion” to qualify for membership eligibility.¹⁶

In order to develop a robust framework that ensures parent or affiliate institutions have a sufficient nexus to the mission of the FHLBs, MBA recommends that the current regulation be amended slightly and that additional requirements for these institutions be put in place.

Amendments to Current Regulatory Provisions

As is noted above, the existing regulation specifies that the “makes home mortgage loans” requirement of the FHLB Act be proven through a “regulatory financial report” filed with an “appropriate regulator.” The definitions of these two terms within this provision effectively require insurance company members to provide their quarterly or annual National Association of Insurance Commissioners (NAIC) statement, as filed with the relevant state insurance regulator.

To support a framework that also analyzes the parent or affiliate of a captive insurer, FHFA should amend the definition of “regulatory financial report” found in 12 C.F.R. §1263.1 so that this requirement can be applied to the financial reports filed with the appropriate regulator for a parent or affiliate of the captive insurer, consistent with the public reporting or other regulatory oversight regime to which it is subject.

The amended definition of “regulatory financial report” should reference a broader set of financial reports, including Securities and Exchange Commission (SEC) filings and the Mortgage Bankers’ Financial Reporting Form (MBFRF). Together with internal reporting requirements already developed by FHLBs with captive insurer members, these amendments should ensure that the relevant financial and business information regarding a captive insurer member’s parent or affiliate institution is readily available to FHFA and the appropriate FHLB.

Additional Regulatory Provisions

In the RFI, FHFA discusses the development of the 2016 rule, in which it considered requiring applicants or members to meet a minimum level of mortgage originations or purchases. As is noted above, MBA does not believe such a requirement is necessary for current non-captive insurer members or for non-captive insurer applicants. There is no evidence of which MBA is aware that FHLB advances are

¹⁵ 12 C.F.R. §1263.6(a)(6); 12 C.F.R. §1263.13(b).

¹⁶ 12 C.F.R. §1263.6(c).

being accessed in a widespread manner by institutions without a sufficient commitment to housing finance or community investment.

As is further noted by FHFA in the RFI, indirect FHLB membership through a captive insurer could present opportunities for institutions that do not exhibit this nexus to the FHLBs' mission to obtain advances. Because of this possibility, MBA believes it is appropriate for FHFA to set additional mission-oriented requirements for parents or affiliates of captive insurers at the time of membership application.

Two appropriate requirements would focus on the parent or affiliate institution's assets and income. First, FHFA could set a minimum threshold for the percentage of a parent or affiliate institution's assets that are "mortgage-related" – a policy that would effectively define and quantify the existing "mortgage-related assets" requirement for non-depository applicants. This definition should recognize the broad range of assets that supports housing finance, including but not limited to full or partial interests in mortgage loans, mortgage-backed securities (MBS), credit risk transfer securities, mortgage servicing rights (MSRs), and mortgage servicing advance receivables.

Second, FHFA could set a minimum threshold for the percentage of the applicable parent or affiliate institution's income that is derived from "mortgage-related" sources. This definition should again recognize the broad scope of housing finance activities, including but not limited to mortgage origination, mortgage servicing, credit enhancement of mortgage-related assets, and investment in MBS or other mortgage-related securities.

By establishing more stringent requirements with respect to these applicants' commitment to housing finance and community investment at application, FHFA could better ensure that access to FHLB advances is not granted to institutions without a clear nexus to the FHLBs' mission.

FHLB System Safety and Soundness

The FHLB Act requires that, to become eligible for FHLB membership, an institution must be "duly organized under [national or state] laws,"¹⁷ and "subject to inspection and regulation under the [national or state] banking laws, or under similar [national or state] laws."¹⁸ The FHLB Act also includes limits on eligible collateral and provides FHLBs with priority over other parties with respect to security interests in this collateral.¹⁹

¹⁷ 12 U.S.C. §1424(a)(1)(A).

¹⁸ 12 U.S.C. §1424(a)(1)(B).

¹⁹ 12 U.S.C. §1430(a); 12 U.S.C. §1430(e).

The FHLB membership regulation further requires that an eligible institution exhibit a “financial condition...such that advances may be safely made to it”²⁰ and that “the character of its management is consistent with sound and economical home financing.”²¹

In order to develop a robust framework that ensures parent or affiliate guarantor or pledgor institutions do not adversely impact the safety and soundness of the FHLB System, MBA recommends that the current regulation be enhanced to provide additional requirements for these institutions, while also retaining the critical existing requirements that promote safety and soundness. These existing requirements have served as strong safeguards in recent years, as no FHLB has suffered a loss due to exposure to captive insurer members, even in the midst of an unprecedented economic and financial shock as a result of the COVID-19 pandemic. Efforts to further bolster these requirements will only add to the overall safety and soundness of the FHLB System.

This approach was cited in a recent report by the Treasury Department regarding potential reforms to the broader housing finance system. In this report, the Treasury Department noted:

“The collateral eligible to secure [FHLB] advances is already limited by law to mortgage and other assets that generally have a close nexus to the [FHLBs’] mission, such that broader membership eligibility should not necessarily detract from that mission. While there might be unique counterparty or other safety and soundness risks posed by advances to mortgage lenders that are not subject to comprehensive prudential regulation, those risks potentially could be managed through enhanced collateral haircuts, capital requirements, or other counterparty risk management practices (e.g., bankruptcy-remote funding structures). In light of these considerations and the continued evolution of the housing finance system, Congress and FHFA should revisit the [FHLB] membership eligibility restrictions to consider whether captive insurers and other types of financial institutions should be eligible for membership.”²²

²⁰ 12 C.F.R. §1263.6(a)(4).

²¹ 12 C.F.R. §1263.6(a)(5).

²² U.S. Department of the Treasury, “Housing Reform Plan, Pursuant to the Presidential Memorandum Issued March 27, 2019,” September 5, 2019. Available at: https://home.treasury.gov/system/files/136/Treasury-Housing-Finance-Reform-Plan.pdf?mod=article_inline.

MBA agrees that enhancements to the existing safety and soundness requirements, as described in greater detail below, can strike an appropriate balance that allows for responsible reforms to FHLB membership eligibility.

Purchases of FHLB Stock

The FHLB Act and the membership regulation require the FHLBs to maintain capital structures that govern members' purchases of stock in each FHLB.²³ In practice, the stock purchase requirements for members include both a minimum investment (as is necessary under the FHLB Act) and activity-based investments that increase with an FHLB's exposure to that member. This structure ensures that all members have "skin in the game" with respect to their FHLB and that FHLBs strengthen their capital positions as their outstanding advances increase.

MBA recommends that the FHLBs' requirements regarding stock purchases by members be maintained and apply equally to all members. New captive insurer entrants would be held to the same requirements as all other members in this regard.

Parent/Affiliate Guaranty

The FHLB membership regulation allows an affiliate of an FHLB member to pledge collateral to secure advances to the member if certain conditions have been met.²⁴ Under such an arrangement, the FHLB must maintain a legally enforceable security interest in the collateral that is functionally equivalent to the security interest it would have held had the collateral been pledged directly by the member rather than by an affiliate. MBA believes that this requirement should be maintained in its current form, as it ensures that FHLBs only accept collateral from affiliates in a manner that provides the FHLBs with a consistent level of protection.

In the context of captive insurer members, it is also likely necessary that the parent or affiliate provide an ongoing guaranty of all advances provided to the captive insurer. This structure reflects the fact that the captive insurers are unlikely to maintain significant levels of assets or reserves relative to those of the parent or affiliate (or in some cases relative to the level of advances). As such, MBA recommends that captive insurer members be required to provide evidence of an ongoing parent or affiliate guaranty of any prospective FHLB borrowings at the time of application. This type of arrangement was common among captive insurer members in the past, and it should be formalized as part of a revised membership framework.

²³ 12 U.S.C. §1426; 12 C.F.R. Part 1263, Subpart D; 12 C.F.R. Part 1277.

²⁴ 12 C.F.R. §1266.7(g).

Capital and Liquidity

In the RFI, FHFA poses questions related to the potential risks associated with members – or parents or affiliates of members – that are not subject to prudential safety and soundness regulation. FHFA also suggests that an institution subject to prudential regulation is “other things being equal, more likely to be in a sound financial condition than one that is not...”²⁵

The financial condition of FHLB members is clearly of great importance to the FHLBs, as it has a direct bearing on the likelihood that a member will be able to repay any borrowings from its FHLB. As was noted earlier, the housing finance system features a diverse set of institutions. Originators, servicers, and the broader set of capital providers include institutions that are not subject to prudential regulation or that may be subject to prudential regulation by agencies at the state level.

MBA recommends that, rather than attempting to control the types of regulation or supervision to which FHLB members are subject, FHFA instead enhance its regulations to ensure that parents or affiliates that serve as guarantors for captive insurers meet reasonable minimum standards, such as risk-based capital, leverage, and liquidity thresholds. These types of requirements would guard against excessive debt financing, as well as heightened risks regarding an institution’s ability to meet obligations as they come due.

Such requirements could include simple minimum thresholds that would promote stability while also ensuring that the requirements can easily be calculated and implemented. Examples might include various measures of total equity, tangible equity, or Tier 1 capital, as well as liquid assets or unencumbered liquid assets (including not only cash and government- or agency-backed securities, but also sources of committed liquidity such as certain lines of credit or financing facilities for other types of assets). The specific thresholds put in place should appropriately account for an institution’s asset composition and business model.

Collateral Quality and Haircuts

The FHLB Act provides the FHLBs with discretion regarding the quality and amount of collateral required to secure advances, subject to a limited set of acceptable collateral types: whole first mortgage loans on residential property, securities backed by such loans, securities issued or insured/guaranteed by a government agency or government-sponsored enterprise, cash, FHLB deposits, other real estate-related collateral, and, for a limited set of institutions, loans or securities for other non-

²⁵ FHFA, “Federal Home Loan Bank Membership – Request for Input,” February 24, 2020. Available at: <https://www.fhfa.gov/Media/PublicAffairs/PublicAffairsDocuments/RFI-on-FHLBank-Membership.pdf>.

housing purposes.²⁶ The FHLB membership regulation provides further details regarding eligible collateral types and collateral valuation procedures.²⁷

Under the existing regulatory structure, each FHLB may restrict the types of collateral that it will accept based on the credit profile of the borrower and the quality of the collateral, among other reasons. Each FHLB also maintains the ability to set collateral valuation procedures.

Taken together, the requirements on, and authorities of, the FHLBs with respect to collateral produce appropriate levels of discretion for the FHLBs, subject to minimum requirements set by regulation. In practice, the FHLBs overcollateralize their advances as a matter of prudent risk management, with the level of haircuts set to reflect the credit quality of the collateral. The FHLBs should retain this discretion with respect to collateral provided by captive insurers or their parent or affiliate institutions.

Priority of Secured Interests

Another factor that has contributed to the FHLBs' safety and soundness is their ability to access pledged assets ahead of other parties. The FHLB Act provides that "any security interest granted to a[n FHLB] by any member...or any affiliate...shall be entitled to priority over the claims and rights of any party," with limited exceptions.²⁸

With respect to captive insurers, an amended membership framework should allow resolution of FHLB claims in a manner that affords the FHLBs similar protections, to the extent possible under existing laws and regulations, to those they maintain with existing members. To do so, MBA recommends that FHFA require captive insurer parents or affiliates to provide explicit bankruptcy protections to their FHLB counterparties. These protections could take varying forms and should be evaluated by individual FHLBs as a condition of membership eligibility.

One possible approach would entail separating pledged assets from other assets covered by the bankruptcy process. For example, the parent or affiliate of a captive insurer could grant a participation interest in these assets to the captive insurer, which would then be pledged to the FHLB. The arrangement would allow the captive insurer to take control of the pledged assets upon the default of the parent or affiliate, thereby allowing the FHLB to take control of these assets as necessary. Similarly, a captive insurer or its parent or affiliate could pledge to the FHLB assets held in a trust or other bankruptcy-remote vehicle, which would allow the FHLB to take control of these assets ahead of other creditors in the bankruptcy proceedings. These

²⁶ 12 U.S.C. §1430(a).

²⁷ 12 C.F.R. §1266.7; 12 C.F.R. §1266.10.

²⁸ 12 U.S.C. §1430(e).

structures are appropriate for captive insurers located in states that have relevant statutory provisions addressing insurance company insolvency.

Another option would revolve around the use of contracts that provide safe harbor from certain bankruptcy proceedings. These contracts, which include repurchase (repo) agreements, would afford FHLBs similar protections as qualified financial contracts under the Federal Deposit Insurance Act. FHFA and the FHLBs would need to examine any existing statutory impediments to the use of repo agreements for this purpose, and the minimum eligibility requirements should be tailored to reflect these impediments.

There are likely other structures for advances that may be developed to ensure the FHLBs maintain sufficient priority of secured interests in the event of a default by a captive insurer parent or affiliate. As such, FHFA should include minimum standards for evaluation of these structures by the FHLBs with respect to any new member applications, with the FHLBs retaining the discretion to approve any approaches that adhere to these minimum standards.

Financial Reporting and Examinations

The FHLB Act grants the FHLBs the ability to request from several federal financial regulators “such reports, records, or other information as may be available, relating to the condition of any member...or any institution with respect to which any such [FHLB] has had or contemplates having transactions...”²⁹ The results of such reports and records are available for the confidential use of the relevant FHLB, providing the FHLBs with additional data and information with which to monitor their members’ financial health and more reliably engage in risk management practices.

MBA recommends that this authority include reports generated by relevant regulators for the parent or affiliate institutions of captive insurer members. By amending the membership regulation in this manner, FHFA can ensure that the FHLBs have access to a broad range of information that may be needed to conduct due diligence reviews. The FHLBs have routinely requested and received additional reporting from captive insurers and their parents or affiliates; this enhancement essentially would codify this practice.

Use of the Framework

The framework described above provides a series of tools by which FHFA can ensure that any new captive insurer entrants to the FHLB System meet its twin objectives related to mission and safety and soundness. MBA expects that two

²⁹ 12 U.S.C. §1442(a)(1).

classes of potential entrants are particularly well-suited to attain FHLB membership under this framework: mortgage REITs and IMBs. Both mortgage REITs and IMBs primarily engage in housing finance activities and typically maintain robust financial, operational, and risk management practices.

Despite the focus on mortgage REITs and IMBs in the remainder of these comments, MBA believes a strength of the framework is that other types of institutions could be eligible for FHLB membership (e.g., other types of non-depository lenders). That is, membership eligibility through captive insurers would be determined on the merits of each parent or affiliate institution, rather than based on its charter type.

Part III – Application to Mortgage REITs

Primary Uses of Membership

Mortgage REITs serve as critical providers of private capital in the housing finance system through their investments in mortgage-related assets. Several captive insurers affiliated with mortgage REITs are or were FHLB members in good standing, and their experiences provide insight into how such institutions would operate under the proposed framework. Access to FHLB advances would strengthen mortgage REIT financing of mortgage-related assets by diversifying the sources and structure of this financing. FHLB advances would not replace repo agreements as mortgage REITs' primary source of financing, but instead would provide stable, secured financing for a broader range of mortgage-related assets for which repo financing is not always suitable, particular in periods of heightened market volatility.

For some mortgage REITs that currently access (or previously accessed) FHLB advances through captive insurers, one of the primary benefits is this consistency in the availability of financing. During stressed market environments, such as the early stages of the COVID-19 pandemic, securitization markets and other segments of financial markets may experience temporary dislocations. During these dislocations, transaction volume may freeze, and price discovery could be challenging. The FHLBs, which manage their counterparty risk on a daily basis, would increase haircuts or require additional capital in these scenarios, but they would remain a consistent source of financing. As such, they would further support the stability of captive insurers affiliated with mortgage REITs and promote continued access to mortgage financing for borrowers through all parts of the credit cycle.

Nexus to FHLBs' Mission

Mortgage REITs, by the very nature of their business model and tax structure, provide capital to support single-family and multifamily housing, as well as commercial properties, throughout the country. To qualify for REIT status, mortgage

REITs must both derive the vast majority of their income from real estate-related assets and distribute a similar majority of their taxable income to their shareholders, with federal taxes paid on those dividends rather than at the corporate level. By fulfilling this dual mandate annually, and through other requirements, mortgage REITs hold assets that are almost exclusively real estate-related in nature.

Advances to captive insurers affiliated with mortgage REITs have allowed for increased lending to a broader group of creditworthy homeowners than those served by the conventional mortgage market today. The private wholesale funding market has been less suited to supporting loans made to borrowers who fall just outside of the product and underwriting parameters defined by the Qualified Mortgage standard, and mortgage REITs have the ability to step in and fill that void. More broadly, as FHFA and Congress work to better define the long-term activities and market footprint of Fannie Mae and Freddie Mac, mortgage REITs can use the FHLB advances provided to their captive insurer affiliates to channel capital into a range of high-quality, non-agency housing finance assets not currently served by private funding markets.

Based on their business activities, assets, and sources of income, mortgage REITs would almost certainly meet any tests related to alignment with the FHLBs' mission. Their existence centers on housing finance and community investment in ways that make them dedicated participants in the mortgage market.

FHLB System Safety and Soundness

As was noted earlier, MBA believes that, all else equal, a more diverse membership serves as a source of strength for the FHLBs. Additionally, mortgage REITs can be safe and sound counterparties for the FHLBs in the normal course of their operations, provided they meet minimum requirements instituted by FHFA. For example, to MBA's knowledge, even through the severe market dislocations and rapid re-pricing of assets and collateral that occurred as a result of the COVID-19 pandemic, no captive insurer affiliated with a mortgage REIT defaulted on its advances.

Mortgage REITs with captive insurer affiliates that are FHLB members first would be subject to the existing safeguards that are built into the FHLB System. Mortgage REITs' captive insurer affiliates would be required to purchase FHLB stock and pledge (or have their parents or affiliates pledge) acceptable collateral on which haircuts are applied, as determined by each FHLB. A parent/affiliate guaranty would cover any advances provided to the captive insurer member. These conditions have previously been met by those mortgage REITs with captive insurer affiliates that are or were members of the FHLB System.

Under the requirements of the framework suggested above, any eligible mortgage REIT would need to provide evidence that its capital and/or liquidity positions meet minimum thresholds set by FHFA. There is a wide range in the use of leverage, for example, in the mortgage REIT sector, and an appropriate level of leverage for each mortgage REIT depends heavily on the nature of its mortgage investment activity, the liquidity of its portfolio, and its capital allocation among mortgages and mortgage-related assets. The framework described above would need to be designed to ensure that institutions that rely on levels of leverage deemed too high (given their asset composition and business model) to make them acceptable counterparties to an FHLB are not granted eligibility. These types of requirements effectively would set prudential standards for mortgage REITs with captive insurer affiliates entering the FHLB System.

Mortgage REITs that are publicly listed also must adhere to specific guidelines and requirements for financial disclosures as implemented by the SEC. These disclosures include quarterly and annual financial reporting, and could include additional reporting as determined necessary by a particular FHLB.

Finally, mortgage REITs and/or their captive insurer affiliates would be required to offer the FHLBs bankruptcy protection with respect to pledged assets in a manner that satisfies the standards set forth in the framework. While the exact structure of this protection could vary from institution to institution, any acceptable approach should provide further confidence to the FHLBs that they would be able to access collateral without delay.

Part IV – Application to Independent Mortgage Banks

Primary Uses of Membership

IMBs are critical players in the housing finance system, currently originating more than half of single-family loans throughout the country. Because they do not have deposit bases that are akin to those of banks or credit unions, IMBs instead rely on warehouse lines from other institutions (typically banks) to fund the mortgages they originate until those loans are sold into the secondary market – typically within a few days to a few weeks.

The existing system of warehouse funding works efficiently and effectively, as there are many providers of warehouse lines that compete in a robust market, which in turn boosts liquidity and lowers costs for consumers. Warehouse lenders also serve as an important source of oversight with respect to IMB risk management practices. Through their regular monitoring of various IMB financial and operational covenants, warehouse lenders provide a “front-line” form of counterparty diligence.

Access to FHLB advances through captive insurer affiliates would not be a primary source of funding for IMBs in the ordinary course of business, but rather an alternative source that would be available for specific situations or in periods of severe market stress. For example, FHLB advances could be used to finance high-quality loans that become investor-ineligible due to minor discrepancies with investor guidelines. Similarly, buyouts of loans that become delinquent and are in a loss mitigation program or are modified could be financed through FHLB advances in certain situations to better allow IMBs to focus their warehouse funding on their loan pipelines. In addition to loans, servicing advance receivables or certain types of mortgage securities could be financed efficiently through FHLB advances.

IMBs may also seek to sell some loans directly to the FHLBs through the Mortgage Partnership Finance (MPF) program and Mortgage Purchase Program (MPP). These additional outlets for loan sales would provide IMBs with greater secondary market access and liquidity, while also providing the FHLBs with another source of high-quality mortgage assets and further promoting affordable housing for consumers.

Nexus to FHLBs' Mission

As the largest segment of single-family mortgage originators, IMBs are uniquely aligned with the mission of the FHLBs. They are typically monoline companies that focus the entirety of their business on housing finance, which in many cases includes mortgage servicing as well as origination activity. IMBs' historic and current contributions to the mortgage market reinforce their importance in promoting homeownership throughout the country.

IMBs are the predominant lenders of government-insured or -guaranteed loans – markets where IMBs stepped in to fill voids that were left in the wake of the Great Recession. As a result, IMBs serve a disproportionate share of first-time homebuyers, low- to moderate-income families, and communities of color. Their business model allows global investment capital to be channeled into local housing markets, promoting access to credit at affordable costs to borrowers.

Substantially all IMB assets and income sources are mortgage-related, and IMBs are primarily engaged in housing finance and community investment at all times, through all parts of the credit cycle. IMBs should therefore satisfy any asset or income tests applied to potential FHLB members.

FHLB System Safety and Soundness

As with other types of institutions that gain access to FHLB advances through captive insurers under this framework, IMBs would be required to abide by several existing FHLB requirements and safeguards, including FHLB stock purchases, a

parent/affiliate guaranty, and collateral standards and haircuts. To the extent IMBs pledge collateral that is deemed by an FHLB to be more volatile than agency MBS or whole loans (for example, interest rate-sensitive MSR), the FHLB maintains discretion to set collateral-specific haircuts that reflect this risk.

IMBs are also subject to robust regulation and supervision, as well as licensing requirements, by state regulators in each state in which they do business. Loan officers at IMBs are licensed and subject to stringent continuing education requirements. The quarterly financial data and annual lending data that IMBs submit to their regulators could be made available to FHLB counterparties under the framework.

State regulators impose capital, liquidity, and net worth requirements on IMBs, which in many ways mirror some of the prudential standards espoused by FHFA in the RFI. These state regulators also conduct regular onsite supervisory examinations that address prudential and consumer protection matters, prepare written supervisory reports, and share supervisory information with other state and federal regulators. Many IMBs are similarly subject to capital, liquidity, and net worth requirements set by Ginnie Mae or by FHFA with respect to Fannie Mae or Freddie Mac counterparties. Given that FHFA already sets such requirements for IMBs that conduct business with Fannie Mae and Freddie Mac, these requirements are an appropriate starting point for FHLB counterparty standards.

As with mortgage REITs, IMBs would be required to offer the FHLBs bankruptcy protection with respect to pledged assets in a manner that satisfies the standards set forth in the framework. While the exact structure of this protection could vary from institution to institution, any acceptable approach should provide further confidence to the FHLBs that they can access collateral without delay.

* * *

MBA believes the development of a framework based on the considerations above would allow for responsible expansion of FHLB membership in a manner that achieves both objectives set forth by FHFA – promotion of the FHLBs’ mission and strengthening of the System’s safety and soundness. Increased diversity in FHLB members would more accurately reflect the breadth of institutions that contribute to the national system of housing finance, in effect creating a “21st Century” FHLB System.

To do so, FHFA should amend its 2016 rulemaking on FHLB membership eligibility to allow captive insurer members, subject to several new and existing safeguards related to both mission and safety and soundness. While a revised framework for captive insurer affiliates would not discriminate based on charter type, two sets of

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institutions most likely to satisfy updated requirements would be mortgage REITs and IMBs. This outcome is appropriate, given the contributions that both sets of institutions make to housing finance and community investment. The addition of well-managed mortgage REITs and IMBs to the FHLB System represents a strengthening of the System in line with FHFA's stated objectives in the RFI.

Thank you in advance for your consideration of these comments. Should you have questions or wish to discuss further, please contact Pete Mills, Senior Vice President of Residential Policy and Member Engagement, at (202) 557-2878 and pmills@mba.org.

Sincerely,

A handwritten signature in black ink, appearing to read 'R. Broeksmit', with a stylized flourish at the end.

Robert D. Broeksmit, CMB
President and Chief Executive Officer
Mortgage Bankers Association