FHLBank
San Francisco

January 12, 2015

VIA ELECTRONIC SUBMISSION ON WWW.FHFA.GOV

Alfred M. Pollard, General Counsel
Attention: Comments/RIN 2590-AA39
Federal Housing Finance Agency
400 Seventh Street SW, Eighth Floor
Washington, D.C. 20024

Re: Notice of Proposed Rulemaking and Request for Comments – Members of Federal Home Loan Banks (RIN 2590-AA39)

Dear Mr. Pollard:

The Federal Home Loan Bank of San Francisco ("FHLBSF") is writing to comment on the Federal Housing Finance Agency's ("FHFA") notice of proposed rulemaking ("NPR") regarding members of the Federal Home Loan Banks ("FHLBanks"). The NPR (RIN 2590-AA39) states that the FHFA seeks to address issues related to the membership requirements and the FHLBanks' housing finance mission through revisions to several of its regulations regarding membership eligibility. FHLBSF appreciates the FHFA's attention to membership eligibility and its goal of ensuring that membership requirements are consistent with the FHLBanks' housing finance mission and welcomes the opportunity to provide comments on the NPR. As the FHFA considers changes to the membership requirements for the FHLBank System, it is important to be mindful of the continued need for the low-cost, readily available mortgage, economic development, community development, and small business credit that the FHLBanks are statutorily charged with facilitating through a diverse set of members.

Although the proposed new membership rules may affect only a small segment of FHLBSF's current membership base, they would adversely affect the certainty of access to FHLBank funding that has proven to be a cornerstone of the nation's financial system, particularly in times of crisis. In addition, the proposed rules appear to run counter to clear Congressional intent over time to broaden access to FHLBank membership eligibility. Congress has considered FHLBank membership on multiple occasions over the past two decades and has consistently acted to expand, rather than restrict, access to membership and to all of the benefits that membership confers on its members. Given a lack of compelling evidence that current membership rules are misused by members that do not engage in mission-consistent activity following their membership approval, and given the potential broad negative consequences of implementing the new membership rules as proposed, FHLBSF respectfully requests the FHFA

to withdraw the NPR and restart the process of considering how best to align FHLBank membership eligibility rules with the Federal Home Loan Bank Act, as amended ("FHLBank Act"), and the critically important role of the FHLBanks in the nation's housing finance system. However, if the FHFA concludes that its responsibility to oversee the FHLBanks' determination of membership eligibility requires the implementation of new membership rules such as those proposed in the NPR, FHLBSF requests that the FHFA take into consideration FHLBSF's comments and suggestions on how the FHFA may be able to mitigate some of the adverse consequences of the new rules on the FHLBank System and its many members.

I. GENERAL COMMENTS

A. Legislative History Suggests an Expansive View of FHLBank Membership

The NPR would reverse Congressional direction in recent relevant legislation by restricting FHLBank membership. Prior to 1989, the FHLBanks were primarily the source of mortgage credit for savings and loan institutions and savings banks (although insurance companies were eligible for membership). Beginning with the Financial Institutions Reform, Recovery and Enforcement Act of 1989 ("FIRREA") and continuing with the Gramm-Leach-Bliley Act ("GLBA") in 1999 and the Housing and Economic Recovery Act of 2008 ("HERA"), Congress expanded FHLBank membership eligibility and the mission of the FHLBanks. Specifically, FIRREA expanded FHLBank membership to include all federally insured depositories, including commercial banks and credit unions. The GLBA created a class of membership for insured depositories with assets below a set threshold. These community financial institutions ("CFIs") were exempted from the membership requirement that insured depositories have at least 10% of their total assets in residential mortgage loans and were authorized to pledge as collateral certain non-mortgage assets, including small farm loans and small business loans, to support their credit obligations with FHLBanks. HERA further expanded FHLBank membership to include community development financial institutions ("CDFIs"). The effect of the proposals as set forth in the NPR would be to exclude from membership current and prospective members that have previously been eligible, thereby reversing the thrust of laws written by Congress in the last 25 years.

Because the proposed changes are inconsistent with the implied intent of Congress, they should be considered and accomplished through legislative, not regulatory, action. The FHLBSF contends that the Congressional expansion of membership access and of asset classes eligible for collateral pledging reflects the continual commitment of Congress to the core function of the FHLBank System – to provide liquidity through its members in order to expand the amount of mortgage, community development, economic development, and small business credit available in communities throughout the country. It is critical that the FHLBanks continue this

essential function, even as the institutions that provide mortgage credit, community development credit, economic development credit, and small business credit change. As the economy and housing markets struggle to recover from the worst recession since the Great Depression, it is critical that the FHLBanks facilitate credit that will stimulate economic growth.

1. Quantitative asset tests were never intended for CFIs and other non-depository members

The Congressional acts that expanded membership eligibility to include CFIs and CDFIs specifically did not include quantitative asset tests for the purpose of determining membership eligibility. Insurance companies, which have been eligible for FHLBank membership since the inception of the FHLBank System in 1932, have never been subject to quantitative membership eligibility asset tests. Including specific quantitative tests for these member classes appears to contravene the implied intent of Congress and could make it more difficult for these types of institutions to become or remain members of the FHLBank System.

2. Congress has never acted to limit insurance company membership

The NPR would exclude from membership any insurance company that does not conduct insurance company business with unaffiliated third parties. Insurance companies have been eligible for FHLBank membership since the FHLBank System was created in 1932. At no time in the past 82 years has Congress suggested that FHLBank membership should be limited to certain types or classes of insurance companies. If there are concerns about the potential risks that certain classes of insurance companies pose to the financial health of the FHLBank System, the FHFA should review FHLBank credit and collateral frameworks to ensure they are adequate in addressing these risks.

B. Ongoing Eligibility Requirements

1. Ongoing eligibility requirements could disrupt some members' strategic plans and could harm members caught in a business cycle where holding on-balance sheet real estate or home mortgage loan assets is not profitable

If the proposed eligibility asset tests were performed in 2014, FHLBSF estimates that six of its members would not qualify for membership based on either the residential mortgage test or the makes home mortgage loans test, or because the member is an insurance company that does not transact insurance business with unaffiliated third parties.[1] While these members represent only a small fraction of FHLBSF's total membership and total outstanding credit, the

[1] Asset ratio calculations are based on a three-year average of yearends from 2011, 2012, and 2013.

impact of the loss of membership on certain members could be large. For example, for members that would not pass the eligibility tests, their ability to provide products and services to the communities they serve could be significantly hampered. This underscores the need to adopt alternative evaluation criteria that mitigates the exclusion of institutions that have a track record of mortgage lending and effectively serving their communities. For example, an institution's overall mortgage lending, including origination and sale of mortgages, should be considered. In addition, an institution's loan-to-assets ratio may show that it is fulfilling borrower needs in its community, even though its focus may be primarily on consumer installment and small business loans. Another review element could be the institution's CRA rating, which provides a clear indication of whether the institution meets community needs.

If ongoing membership eligibility tests must be included in the final rule to achieve the FHFA's regulatory oversight objectives, FHLBSF suggests the tests begin on a prospective basis to allow members to appropriately adjust their balance sheets. For example, the first yearend used in the averaging could be December 31, 2015, with the implementation of ongoing membership tests starting in 2018 using yearend data for 2015, 2016, and 2017.

2. New continuous membership rules would diminish the perceived reliability of FHLBanks

FHLBSF reiterates the concern expressed by all 12 FHLBanks in their letter to the FHFA dated March 23, 2011, regarding ongoing membership requirements addressed in the 2010 Advance Notice of Proposed Rulemaking, that the proposed ongoing membership requirements introduce an element of uncertainty and instability to FHLBank membership. As a result, FHLBanks could be viewed by both existing and potential members, and their regulators, as less reliable funding partners. In addition, if the membership rules result in significant membership terminations, the capital stock bases of the FHLBanks could become more volatile, decreasing the stability of the FHLBank System and its effectiveness in meeting national housing finance and community development policy objectives. The final rule should not have a "rolling membership" process that requires a continuous re-evaluation of membership eligibility because this could lead to a high degree of market uncertainty and make it difficult for the FHLBSF and other FHLBanks to support member development and execution of credible long-term market strategies for communities most in need of access to housing, economic development, community development, and small business credit.

FHLBSF requests that the FHFA provide flexibility to members to allow them to adapt to changing market conditions, rather than constrain members to particular business models. Markets are not static, and housing finance adjusts to differing market conditions. This is why it has been so critical that the FHLBanks' own capital structures have allowed them to expand and

contract their balance sheets in response to changes in market conditions and demand for advances. Members also need this kind of flexibility. Before securitization, mortgage credit availability was limited to portfolio lenders and the balance sheets of Fannie Mae and Freddie Mac. Securitization expanded the market and afforded lenders the opportunity to make more loans and allow more families to own their own homes. In the future, some lenders may originate and sell more mortgage loans than they do now, relative to the amount of loans they hold in portfolio, while others may choose to originate and hold such loans. Both strategies serve the needs of families seeking to own a home, and neither should be subject to unnecessary regulatory limits. The FHFA should take a flexible approach to permit market participants to meet future credit demands in their communities.

3. Smaller credit unions should be eligible for CFI-like membership standards

Under the current membership rules, credit union applicants, regardless of size, are subject to the 10% residential mortgage loans test. Smaller credit unions are in many ways similar to commercial bank or thrift CFIs that are not subject to the 10% real estate mortgage loans test. If membership eligibility tests are imposed, FHLBSF suggests that credit unions be subject to the same CFI-level asset thresholds as commercial banks and thrifts for membership eligibility purposes. In addition, FHLBSF suggests that the FHFA permit credit unions that meet the CFI asset thresholds to pledge the same type of CFI collateral as commercial bank and thrift CFIs to secure their outstanding credit obligations with their FHLBanks. Creating this fair treatment is consistent with other sections of FHFA regulations, would more appropriately reflect today's marketplace, and would increase competition in making housing credit available, to the benefit of consumers.

4. FHFA's proposed rules would be harmful to CFIs and CDFIs

The proposed rules would be particularly harmful to certain small financial institutions, CFIs and CDFIs, even though Congress expanded eligibility to these member categories without an explicit and quantitative home mortgage test requirement. In the case of CFIs, Congress has authorized and encouraged the FHLBanks to make advances to CFIs to support funding for expanded activities involving small businesses, small farms, small agribusiness, and community development activities. Requiring these members to hold a specified percentage of their assets in home mortgage loans appears to contravene the intent of Congress. FHLBSF urges the FHFA to position the FHLBank System to continue to serve a purpose that includes access to credit not only for prospective homeowners but specific segmented markets that need capital for business expansion and economic development.

In addition, CFIs face an additional complication if their asset levels grow beyond the CFI threshold. In the event a member is no longer eligible for CFI status, it would immediately

become subject to the 10% real estate mortgage loans test, in addition to the makes home mortgage loans test. Because adjusting business models can take time, FHLBSF suggests the final rule provide members that newly exceed the CFI asset threshold a sufficiently long grace period to attain compliance with the new requirement. Specifically, FHLBSF recommends that the first yearend data set for use in the calculation be the yearend following the loss of the member's CFI status. This would provide members that lose their CFI status a more reasonable amount of time to alter their business models and adjust their balance sheets to remain eligible for membership, if they choose to do so.

5. The makes home mortgage loans test percentage should not exceed 1%

The proposed rule includes a 1% makes home mortgage loans test applicable to all members. The proposed rule also suggests that the final rule could include a higher percentage. To the extent that the FHFA deems an explicit quantitative "makes" test is necessary, FHLBSF believes that a 1% test is not unreasonable and would be less disruptive for members. Increasing the percentage beyond 1% could unduly and negatively affect the CFI and CDFI membership categories.

6. The operational burden on FHLBanks would be significant

The proposed tests impose a significant burden on the FHLBanks because the required member financial information is not perfectly aligned with specific call report line items. This is particularly true for credit union call reports. FHLBSF recommends that the FHFA provide the FHLBanks with specific guidance on which call and regulatory report fields to use for each member type. As many of these report line items are compiled electronically, any new disclosure requirements should seek to build upon standard information sets collected and reported electronically within each of the FHLBanks.

C. Captive Insurance Companies

The NPR proposes to define insurance companies eligible for FHLBank membership to exclude insurance companies that do not have a primary business purpose to underwrite insurance for nonaffiliated persons or entities. The stated purpose of the definition is to exclude captive insurance companies from membership because they may be created and used by other entities that are not otherwise eligible for FHLBank membership.

While FHLBSF acknowledges the possibility that entities such as real estate investment trusts (REITs) and other non-bank mortgage companies could use captive insurance companies for this purpose, FHLBSF believes that continuing to allow captive insurers to be eligible for FHLBank membership is consistent with both the FHLBanks' housing mission and the original

FHLBank Act, which includes all insurance companies as eligible for FHLBank membership. REITs and other mortgage companies are of increasing importance in the nation's housing markets, and FHLBSF believes that membership for their captive insurance companies is appropriate given the FHLBanks' housing finance mission. In addition, the proposed restriction for insurance companies that are not doing insurance business with unaffiliated third parties may cause harm to existing insurance companies that have been long-time members of the FHLBank System and that have captive or reinsurance activities as their primary business. These members use FHLBank advances and participate in the Affordable Housing Program.

FHLBSF believes that appropriate credit and collateral frameworks can be developed by the FHLBanks to mitigate the risks associated with lending to these members. Rather than redefining the term insurance company to exclude captive insurance companies, FHLBSF recommends that the FHFA focus its efforts on ensuring that each FHLBank's credit and collateral frameworks are adjusted as necessary to reflect the unique risks associated with lending to captives of different types of parent entities.

D. Principal Place of Business

For the purpose of determining the appropriate FHLBank district for membership, the NPR would require that FHLBanks not rely solely on the statutory domicile of an insurance company. Instead, the FHLBanks would have to consider other aspects of the entity, including where the entity is effectively managed. Requiring insurance company applicants and the FHLBanks to consider multiple factors, including some factors that are subject to significant ambiguity, would create a barrier for entry for insurance companies that differs from the requirements for other membership segments, would place a significant burden on the FHLBanks, and would create confusion among member applicants and the FHLBanks about the appropriate FHLBank district for membership. This, in turn, could lead to different interpretations by different FHLBanks and challenges by member applicants that have a preference about which FHLBank they would like to join. Instead, FHLBSF suggests the FHFA allow the FHLBanks to follow their pre-2012 practice of relying on an insurance company member's state of domicile for the purpose of determining the appropriate FHLBank district for membership. This approach would be consistent with the approach used by the FHLBanks for other member types.

Domicile is extremely important in the context of insurance company operations and regulation. Insurance companies are subject to pervasive and ongoing regulation and contact with their domiciliary states, including being subject to comprehensive examinations and ongoing reporting requirements and being required to obtain approval in regard to any acquisition, control, merger, or similar corporate action. The corporate powers of a domiciled

insurance company, including its authority to borrow and pledge assets to secure borrowings, are derived from and governed by the insurance code of the state of domicile. Because insurance companies are chartered under state law rather than federal law and are subject to primary regulation, inspection, and supervisory oversight by their state insurance regulators, the domiciliary state insurance code is critical to an applicant's operations and to its ability to become a member of an FHLBank and borrow from the FHLBank, as well as the FHLBank's rights and obligations as a secured creditor.

The state insurance department of an insurance company's state of domicile also plays a critical role in the insurance company's rehabilitation and insolvency. Most states provide the rehabilitator substantial financial control over the insurance company, including the ability to manage and dispose of the insurance company's property. Further, creditor's rights regarding insurance companies are also governed by state law.

For these reasons, FHLBSF suggests that the location of domicile should be the primary driver in determining the appropriate FHLBank district, unless a prospective member specifically requests membership in a different FHLBank by requesting a separate "principal place of business" designation. An alternative suggestion would be to allow domicile to be the determining factor, as long as the entity has an actual business presence in the state of domicile. Either recommendation would clarify for the FHLBanks and applicants which FHLBank is appropriate for membership and minimize confusion and operational burdens.

II. SPECIFIC QUESTIONS POSED IN THE NPR

FHLBSF has suggestions responding to some of the specific questions posed in the NPR, as follows:

A. Member Decisions

Question: Whether the FHFA should continue to permit applicants that have been denied membership by an FHLBank to appeal such denials to the FHFA.

Response: FHLBSF supports the ability of applicants that have been denied membership by an FHLBank to appeal the denial to the FHFA.

B. Effect of "Flow" Business on Makes Home Mortgage Loans Test

Question: Whether the final rule should include a provision that takes into account a member's "flow" business, and if so, how an FHLBank should be required to obtain the necessary data.

Response: Member balance sheet data may not fully reflect the institution's engagement and commitment to real estate and home mortgage loans. FHLBSF suggests that loans that are originated by a member and subsequently sold can be used in whole, or at least in part, to satisfy the membership 10% real estate mortgage loans test and the makes home mortgage loans test. Focusing on point-in-time measurements does not fully capture the flow of credit into the origination housing finance market and the ability of FHLBank members to reenter the market for further originations.

C. Percentage for Makes Home Mortgage Loans Test

Question: Whether to establish the makes home mortgage loans standard at some higher percentage, such as two percent, or possibly as high as five percent, as part of this rulemaking.

Response: If FHFA determines that a test is required, FHLBSF believes that one percent is a sufficiently high standard for purposes of the makes home mortgage loans test, balancing the requirement of members to demonstrate their commitment to housing finance with the implied Congressional intent to allow FHLBank access for institutions such as CFIs and CDFIs, which may have business models focused on community and economic development rather than on housing finance.

Question: Whether setting the minimum required home mortgage loans-to-total-assets ratio at a percentage greater than one percent of a member's total assets would be more consistent with the statutory intent and, if so, what the appropriate percentage should be in the final rule.

Response: Increasing the standard beyond one percent could cause some institutions, such as certain CDFIs, to become ineligible for membership. CDFIs were made eligible for membership by HERA in 2008 and they fulfill other important policy objectives outside of direct housing finance activity.

D. Insurance Company Financial Condition

Question: What type of metrics or other criteria would be appropriate indicators that an insurance company is in a financial condition such that advances may be safely made to it and how should such metrics or benchmarks reflect the business models and risks insured by different types of insurance companies?

Response: Indicators of an insurance company's financial condition might include metrics pertaining to the level and trend of earnings, the level of non-performing assets,

risk-based capital ratios, and certain liquidity ratios. However, the insurance sector is comprised of diverse sub-sectors. As a result, comparisons and ratio requirements across sectors would not necessarily be appropriate. In addition, individual state receivership laws may vary. Underwriting benchmarks and metrics should reflect the significant differences across the various insurance company sectors and their business models, in addition to differences in state regulation.

E. Burden Estimates of Proposed Rule

Question: Ways to minimize the burden of the proposed collection of information on respondents, including through the use of automated collection techniques or other forms of information technology

Response: The burden would be substantially reduced if the financial information used in the calculations could be directly correlated to information available on member and applicant regulatory or call reports, as these are amended from time to time.

We appreciate your consideration of these comments.

Sincerely,

Dean Schultz
President and Chief Executive Officer