BankThink Keep nonbanks out of the Home Loan Bank System

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The Pennsylvania Bankers Association opposes allowing nonbanks to become members of Federal Home Loan Bank System through sponsored captive insurance companies.

Current Home Loan bank membership includes insured depository institutions and credit unions, traditional insurance companies that write third-party insurance policies and community development financial institutions. The prudential supervision of members is central to the Home Loan banks' low risk profile. Since the system's inception in 1932, it has never suffered a loss on an advance to a member, which assures that Home Loan banks have continuous capital market access — even during periods of financial stress. Many members of PA Bankers are members of a Home Loan bank, and the Federal Home Loan Bank of Pittsburgh is a member of our association.

The Federal Home Loan Bank System serves a fundamental role in providing liquidity to member financial institutions that deploy these funds for lending in their communities, which supports housing, business development and economic development throughout Pennsylvania and the entire country. Unlike nonbanks, PA Bankers' members are inextricably linked to our communities through service, charitable partnerships and making credit available so families and business owners can realize their dreams. Our relationships with communities and local leaders often span generations. Unlike nonbanks, we cannot pick and choose which markets we support. We would not want it any other way.

Expansion of Home Loan bank membership to nonbanks through captive insurance charters would change the competitive marketplace in which our members operate by allowing financial players that do not have the operating costs and strictures imposed by prudential supervision to operate on an unlevel playing field. Supporting unfair competition by opening access to system funding for nonbanks would drive business to nonbanks, which would increase economic instability during times of economic stress.

One need only look at the experience of nonbanks during the financial crisis of 2008 to see what might happen during the next severe downturn. Had nonbanks been able to join the Federal Home Loan Bank System through captives before the crisis, the post-crisis system could look very different. The post-crisis pain suffered by credit-starved communities throughout the country could have been much worse.

The Federal Housing Finance Agency published a final rule in January 2016 that prohibits mortgage REITs, hedge funds, social lending platforms and other companies from gaining access to the Federal Home Loan Bank System through ownership of captive insurance subsidiaries. The rule provides a five-year grandfather for nonbank-owned captive insurance companies that became members before the issuance of the proposed rule. That five-year clock started ticking when the final rule was issued in January 2016. Since the rule became final, two nonbanks have purchased grandfathered captive members, adding another element to this approach of back-door membership.

PA Bankers supports the Federal Housing Finance Agency's determination that captive insurance companies be excluded from FHLBank membership. The nonbank parents of some of these institutions present far too much unknown risk to the conservative and well-run Federal Home Loan Bank System, which exists to meet the funding needs of its more than 7,000 regulated members, while serving as an essential component of the nation's financial infrastructure. As Moody's noted in reaction to the final regulation, "This rule is credit positive for the FHLBank System because it eliminates the elevated risks of lending to captive insurance companies versus lending to bank and traditional insurance company members." Expanding membership to include nonbank entities could dramatically change the nature of Home Loan banks in ways that are not in the best interests of existing members, stakeholders and taxpayers.

Last Congress, legislation was offered in the House and Senate to make permanent the membership of the five-year captives. Some legislation goes even further, allowing a broad range of other nonbanks to become Home Loan bank members through captive insurance companies. Such legislation would dramatically change the risk profile of the system and subject it to increased instability in times of economic stress.

If a Home Loan bank should incur a credit loss on an advance to a nonbank member, those losses would be borne by existing members. Since these losses would hurt Home Loan bank earnings, the Affordable Housing Program would also be harmed, as the AHP is funded by 10% of each Home Loan bank's net income.

Maintaining the low-risk business model of Federal Home Loan banks is important to Pennsylvania's bankers and the communities they serve. Home Loan banks are an important element of the nation's financial infrastructure that assures financial institutions operate in the safest possible environment and that local communities have access to credit through institutions that serve those markets.

For these reasons, we believe nonbanks should not be allowed to become Home Loan bank members either through legislation or regulation.

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