



June 26, 2017

Craig S. Phillips  
Counselor to The Secretary  
U.S. Department of Treasury  
1500 Pennsylvania Ave., NW  
Washington, DC

Dear Craig,

NATIONAL  
ASSOCIATION  
OF  
REAL ESTATE  
INVESTMENT  
TRUSTS®  
♦ ♦ ♦  
REITS:  
BUILDING  
DIVIDENDS  
AND  
DIVERSIFICATION®

Thanks for meeting on May 17, 2017 with the Executive Committee of the Mortgage REIT Council of the National Association of Real Estate Investment Trusts (NAREIT<sup>1</sup>). We found the discussion useful and we are pleased that you were able to hear our perspective that policy steps should be taken to increase the flow of private capital into mortgage credit markets.

In particular, we appreciated the opportunity to update you on the current contributions that MREITs make to housing finance. As discussed, we believe that MREITs could beneficially and prudently expand their support for the housing sector if certain regulatory constraints now limiting their involvement can be addressed. These constraints include (i) regulatory impediments limiting MREIT participation in GSE Credit Risk Transfer (CRT) securities; and (ii) the Federal Housing Finance Agency’s 2016 decision to render MREIT captives ineligible for Federal Home Loan Bank membership.

We appreciate your kind offer to review additional materials related to these matters. In response, attached are two separate memoranda addressing these topics. Our hope is that these summaries will provide useful background to you and your staff.

NAREIT looks forward to working with you and the staff of the Department of Treasury as you move forward with your agenda. We hope that you will view NAREIT as a resource in months ahead. Please do not hesitate to contact me, NAREIT’s EVP & General Counsel, Tony Edwards ([tedwards@nareit.com](mailto:tedwards@nareit.com)) or ((202) 739-9408), or Victoria Rostow, SVP, Policy & Regulatory Affairs ([vrostow@nareit.com](mailto:vrostow@nareit.com)) or ((202) 739-9431) with any questions or requests for additional information.

Sincerely,

Steven A. Wechsler  
President and CEO

---

<sup>1</sup> The National Association of Real Estate Investment Trusts (NAREIT) is the worldwide representative voice for real estate investment trusts (REITs) and publicly-traded real estate companies with an interest in U.S. real estate and capital markets. NAREIT’s members are REITs and other real estate businesses throughout the world that own, operate and finance residential and commercial real estate.

***Mortgage REITs (MREITs) and Credit Risk Transfer (CRT) Securities  
Issued by Government Sponsored Enterprises (GSEs)  
The National Association of Real Estate Investment Trusts (NAREIT)<sup>1</sup>  
June 26, 2017***

***NAREIT's MREIT Council and MREITs***

NAREIT's MREIT Council (MREIT Council or the Council), which includes both residential and commercial Mortgage REITs (MREITs), advises NAREIT's leadership on MREIT matters. Residential MREITs serve the U.S. housing market by funding the acquisition and financing of single-family mortgages and mortgage-related instruments and by purchasing mortgages and mortgage-related loans. Commercial MREITs provide financing for commercial real estate, including, importantly, multi-family housing. They invest in commercial mortgages and commercial real estate loans, CMBS, mezzanine loans, subordinated securities or construction loans and participate in loan securitizations.<sup>2</sup>

Most large residential and commercial MREITs are SEC-registered (and therefore subject to the disclosure requirements of the securities laws) and listed on either the NYSE or NASDAQ. They efficiently raise private capital for single family and multi-family housing without reliance on federal guarantees or insured deposits. MREITs raised \$88.2 billion in total equity offerings between 2005 and March 2017. As of May 2017, there were 25 listed residential Mortgage REITs with an equity market capitalization of \$47.3 billion and 14 listed commercial MREITs with an equity market capitalization of \$16.1 billion.<sup>3</sup>

MREITs hold mortgages and MBS on their balance sheets and fund these investments with a variety of sources, including common and preferred equity, repurchase agreements, structured financing, convertible and long-term debt, and other credit facilities. MREITs typically use less borrowing and more equity capital to finance their acquisitions of mortgages and MBS than do other large mortgage investors. At December 31, 2016, the asset-weighted average equity capital ratio of all stock exchange-listed MREITs was 15.1 percent, compared to 9.5 percent for the commercial banking industry and 7.5 percent for the investment banking industry. MREITs were also typically better capitalized than other mortgage investors in the period before the 2008 financial crisis.

---

<sup>1</sup> The National Association of Real Estate Investment Trusts (NAREIT) is the worldwide representative voice for real estate investment trusts (REITs) and publicly-traded real estate companies with an interest in U.S. real estate and capital markets. NAREIT's members are REITs and other real estate businesses throughout the world that own, operate and finance residential and commercial real estate. See [www.nareit.com](http://www.nareit.com).

<sup>2</sup> See [REITWatch](#) (June 2017) at 25. For more information about MREITs, see <http://www.reit.com/investing/reit-basics/guide-mortgage-reits>.

<sup>3</sup> Listed REITs focusing on the ownership and operation of apartments, manufactured housing, student housing, senior housing and single family housing rentals supply significant capital from the public markets to meet housing needs of the country. As of May 31, 2017, the equity market capitalization of REITs specializing in apartments, manufactured housing, student housing and single family homes was \$143,871,058. See, [REITWatch](#), *supra note 1* at 4.

## **REITs and Credit Risk Transfer Securities**

In 2012, the FHFA initiated a strategic plan to develop a program of credit risk transfer securities (CRTs) intended to reduce Fannie Mae's and Freddie Mac's (the GSEs) overall risk to taxpayers. Since then, CRT securities have come to represent the predominant form of GSE non-guaranteed debt issuance. They have enabled a wide range of investors to gain credit exposure to the ongoing recovery of the residential real estate market. However, to date, MREITs have been limited in their ability to participate in CRT issuances by two types of regulatory constraints:

- Current Securities and Exchange Commission (SEC) staff interpretations of the relevant provisions excluding REITs from the requirements of the Investment *Company Act of 1940* ('40 Act)<sup>4</sup>, which recognize only “whole pool” agency and non-agency residential mortgage-backed securities as being “qualifying real estate assets,” and which treat “partial pool” mortgage-backed securities as a “real-estate related asset” (emphasis added); and,
- All REITs must meet the so-called “income and asset tests under the Internal Revenue Code.”<sup>5</sup> The current perspective of the Internal Revenue Service (IRS) appears to be that most CRT issuances to date do not meet the REIT “asset test.”

MREITs have the scale, scope, strength and expertise to economically execute CRT transactions. To the extent they have been permitted to do so consistent with these regulatory issues, they have participated in these issuances since the CRT program's creation. If these two regulatory constraints limiting MREIT participation could be addressed, MREITs could greatly expand their ability to support single-family CRT. Notably, REITs today make up only 2% of the CRT investor base, despite their much greater participation in agency and non-agency MBS markets.<sup>6</sup>

NAREIT and its MREIT Council have been engaged in efforts to educate policy-makers and members of Congress about these regulatory barriers since 2014<sup>7</sup>. Most recently, on April 20, 2017, the MREIT Council filed a [Comment](#) with the Senate Committee on Banking, Housing and Urban Affairs responding to the request by Chairman Mike Crapo (R-ID) and Ranking Member Sherrod Brown (D-OH) for policy proposals to promote economic growth. The Council's Comment noted that certain regulatory limitations on MREIT CRT participation constrains their ability to inject much needed private capital into U.S. housing finance market.

---

<sup>4</sup> See 15 U.S.C. § 80a-3(c)(5)(C).

<sup>5</sup> 26 U.S.C. 856 (a)(7).

<sup>6</sup> See FHFA, [Overview of Fannie Mae And Freddie Mac Credit Risk Transfer Transactions](#) (Aug. 15, 2015).14.

<sup>7</sup> On Oct. 13, 2016, NAREIT joined two other trade associations, the Securities and Financial Markets Association (SIFMA) and the Association of Mortgage Investors (AMI) in submitting a [Comment](#) responding to the Federal Housing Finance Agency (FHFA)'s July 21, 2016 [Request for Input \(RFI\) on Single-Family Credit Risk Transfer](#). The Comment urged FHFA to “prioritize initiatives to eliminate and reduce barriers to broad market participation, including...current regulatory barriers that limit the participation of residential Mortgage REITs (MREITs) in CRT markets.

## **Mortgage REITs and the '40 Act**

Most MREITs rely on the exclusion set forth in Section 3(c)(5)(C)<sup>8</sup> of the '40 Act which excludes any company that: i) “is not engaged in the business of issuing redeemable securities, face-amount certificates of the installment type or periodic payment plan certificates”; and, ii) is “primarily engaged in the business of purchasing or otherwise acquiring mortgages and other liens on and interests in real estate.” Since the 1980s, SEC staff have generally held that a company is “primarily engaged” when at least 55% of the value of its assets are held in so called “qualifying interests”<sup>9</sup> in real estate and the remaining 45% consist primarily of “real estate-type interests.” This interpretation is set forth in a series of “no-action” letters issued by the staff of the SEC’s Division of Investment Management.<sup>10</sup>

SEC staff guidance dating from the mid-1980s<sup>11</sup> further provides that “qualifying interests” in real estate consist *only* of loans or liens fully secured by real estate or actual interests in real estate or assets that can be viewed as the functional and economic equivalent of such loans or liens or interests in real estate. The SEC staff has never updated what we take to be a dated and far too narrow perspective that Agency and non-Agency partial pool certificates are not “qualifying interests.”

Under this framework, most Agency CRT securities issued to date have not been viewed as “qualifying interests” and some not as “real-estate type interests,” due to their technical structure as derivatives or debt obligations of the GSEs with principal payments determined by the credit performance of a reference pool.

Since 2011<sup>12</sup> the MREIT Council has encouraged the SEC and its staff to update these interpretations relating to the definition of a residential mortgage-backed security (RMBS) to account for the evolution of the RMBS securitization markets and the emergence of new RMBS products. The urgency of doing so has increased over time, as policymakers and lawmakers focus more intensively on the imperative of channeling more private capital into housing finance.

In 2016, the Federal Housing Finance Agency (FHFA), the most senior federal housing finance regulator, updated its own definition<sup>13</sup> of a residential mortgage security to reflect the evolution in RMBS markets explaining “that it is appropriate to expand the definition of ‘home mortgage loan’” to include “all types of MBS backed by qualifying assets and eliminate the current

---

<sup>8</sup> See 15 U.S.C. § 80a-3(c)(5)(C).

<sup>9</sup> See, e.g., Securities and Exchange Commission, Salomon Brothers Inc., No-Action Letter (June 17, 1985).

<sup>10</sup> See, e.g., Securities and Exchange Commission, Citytrust, No-Action Letter (Dec. 19, 1990); Securities and Exchange Commission, United Bankers Inc., No-Action Letter (Mar. 23 1988). Note that these SEC staff no-action letters have never been subject to review by the Commission.

<sup>11</sup> Securities and Exchange Commission. Nottingham Realty Securities, Inc., No-Action Letter (April 19, 1984); Securities and Exchange Commission, Division of Investment Management, *The Treatment of Structured Finance Under the Investment Company Act, Protecting Investors: A Half Century of Investment Company Regulation* at 73 (May 1992).

<sup>12</sup> See, e.g., Comment by [Steven A. Wechsler, President and CEO, National Association of Real Estate Investment Trusts \(NAREIT\)](#), File No. S7-34-11 (Nov. 11, 2011).

<sup>13</sup> See 12 CFR 1263.1

distinction that the rules draw between pass-through securities and other types of MBS.”<sup>14</sup> The FHFA’s updated definition of a mortgage security conforms agency’s definitions to the usage of other federal financial regulators, including the Office of Comptroller of Currency (OCC)<sup>15</sup>, Federal Deposit Insurance Corporation (FDIC)<sup>16</sup> and the Federal Reserve Board.<sup>17</sup>

### ***IRS REIT Income and Asset Tests Applicable to All REITs***

To maintain their REIT status, all REITs—Equity REITs and MREITs--must annually satisfy certain rules set forth under the Internal Revenue Code of 1986, as amended, including rules that: i) require that at least 75% of the value of a REIT’s total assets be represented by real estate assets, cash and cash items and government securities (so-called “qualifying assets”); and, ii) require that no less than 75% of a REIT’s income be derived from such qualifying assets.<sup>18</sup>

Currently, it is believed that most CRT securities do not meet the definition of a “real estate asset” for purposes of the 75% asset test, because they do not generally represent interests in real property or mortgages under the strict definition. As discussed below, Fannie Mae and Freddie Mac, working with their regulator, the FHFA, have recently developed proposals intended to overcome these restrictions. This is a promising development, but is still in the planning stage and will not address similar issues arising from non-Agency RMBS and other products.

### ***Proposed Freddie Mac and Fannie Mae CRT Enhancements to Attract REIT Investors***

On May 8, 2017, Freddie Mac and Fannie Mae issued separate announcements that they are exploring structural enhancements of their benchmark CRT securities to “...expand[ing] the potential investor base for these securities, making the program more attractive to Real Estate

---

<sup>14</sup> See *Federal Housing Finance Agency Final Rule: Members of Federal Home Loan Banks, RIN 2590-AA39* (Jan. 12, 2016) (The final rule replaces the existing reference to a pass-through security with a more general reference to a security representing either: (i) a right to receive a portion of the cash flows from a pool of qualifying loans; or (ii) an interest in other securities representing such a right. The reference to a right to receive a portion of the cash flows is intended to encompass both the rights of a holder of a mortgage pass-through security to an undivided ownership interest in the underlying loans and their principal and interest payments, as well as the rights of a holder “debt-type” instruments that grant the holder the right to a specified portion of the cash flows from the pooled mortgage loans”).

<sup>15</sup> See Banking Circular 181 (Rev.), “Purchases of Loans in Whole or in Part Participations;” *see also* OCC Interpretive Letter No. 600 (July 31, 1992).

<sup>16</sup> See [FDIC Analytic Glossary](#) (accessed June 20, 2017) (definition of mortgage backed securities “Certificates of participation in pools of residential mortgages and collateralized mortgage obligations issued or guaranteed by government-sponsored or private enterprises. Also, see “Securities”, below”).

<sup>17</sup> See Board of Governors of the Federal Reserve, [Glossary](#) (accessed June 20, 2017) (“a Mortgage-backed Security (MBS) is a security that is collateralized by a discrete pool of mortgage loans and that makes payments that are based primarily on the performance of those loans.” *See also*, Board of Governors of the Federal Reserve, [LINE ITEM INSTRUCTIONS FOR Weekly Report of Selected Assets and Liabilities of Domestically Chartered Commercial Banks and U.S. Branches and Agencies of Foreign Banks FR 2644](#) (accessed June 20, 2017) (“Item 2.b(1). Other securities: Mortgage-backed securities. For all reporters, include all residential mortgage-backed securities, whether held-to-maturity, available-for-sale, or held-for-trading, issued by non-U.S. Government issuers. Include residential pass-thru securities and other residential mortgage-backed securities (including CMOs, REMICs, CMO and REMIC residuals, stripped mortgage-backed securities, and mortgage-backed commercial paper”).

<sup>18</sup> 26 U.S.C. 856 (a)(7).

Investment Trust (REIT) investors...”. These proposed enhancements to [Freddie Mac’s](#) Structured Agency Credit Risk securities and [Fannie Mae’s](#) Connecticut Avenue Securities (CAS®) would enable future CRT offerings to be structured as notes issued by a trust in an arrangement that qualifies as a Real Estate Mortgage Investment Conduit (REMIC).

These two GSE announcements are not only promising developments, but also signal broad public and mortgage market recognition of the important role that MREITs play in the housing finance arena.

### **Congressional Response**

Late in 2015, three House Democrats introduced *The Partnership to Strengthen Homeownership Act* (H.R. 1491), a bill intended to promote more CRT issuance, that would have also mandated that MREITs be eligible to participate in CRT transactions *pari passu* with other mortgage market players. Although it was not clear that H.R. 1491, which failed to advance for unrelated reasons, would have resolved the constraints on MREIT CRT participation in a workable manner, it was an important step in promoting awareness of this problem.

In 2016, NAREIT’s MREIT Council supported two House bills— the bipartisan [Taxpayer Protections and Market Access for Mortgage Finance Act](#) (H.R. 6487) and the [Moving Housing Forward Act](#) (H.R. 6500) — which also included provisions to address these two perceived regulatory obstacles to greater MREIT participation in Agency CRT issuance.

H.R. 6487 would have expanded the definition of exempt mortgage activities enumerated in Section 3(c)(5)(C) of the ’40 Act to include “purchasing or otherwise acquiring mortgages and other liens on and interests in real estate *including notes, bonds, other evidences of indebtedness, certificates, securities, and other interests, that are a risk-transfer transaction (as such term is defined in section 1328(h) of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992*” (new language in italics). Similarly, H.R. 6487 would have amended the Internal Revenue Code to provide that “*notes, bonds, other evidences of indebtedness, certificates, securities, and other interests that are a risk-transfer transaction (as such term is defined in section 1328(h) of the Federal Housing Enterprises Financial Safety and Soundness Act of 1992*)” satisfy the 75% income and asset tests applicable to REITs.

To address the MREIT constraints, H.R. 6500 would have provided that any financial instrument issued by “an enterprise (or a legal entity sponsored by an enterprise) as part of a credit risk transfer transaction” shall be treated as a “real estate asset” for purposes of Section 3(c)(5)(C) of the ’40 Act and would satisfy the tax code’s REIT 75% income and asset tests.

### **Conclusion**

NAREIT’s MREIT Council continues to strongly support efforts—legislative and regulatory—to eliminate regulatory barriers to greater MREIT participation in U.S. housing finance arena, including the existing barriers to greater MREIT participation in GSE CRT issuance described above. The recent Fannie and Freddie announcements of the possibility of issuing “REIT-friendly” CRT REMIC structured notes affirms that pivotal role of MREITs to the residential

housing finance is broadly acknowledged. Moreover, if these regulatory constraints are surmounted, MREITs have the potential of greatly expanding the private capital contribution to U.S. residential finance.

NAREIT's MREIT Council would welcome the Treasury Department's support and engagement with the SEC, IRS, FHFA, Congress and others in efforts to address these regulatory barriers to greater MREIT CRT participation.

***Mortgage REITs and the Federal Home Loan Banks  
The National Association of Real Estate Investment Trusts (NAREIT)<sup>1</sup>  
June 26, 2017***

***NAREIT's MREIT Council and MREITs***

NAREIT's MREIT Council (MREIT Council or the Council), which includes both residential and commercial Mortgage REITs (MREITs), advises NAREIT's leadership on MREIT matters. Residential MREITs serve the U.S. housing market by funding the acquisition and financing of single-family mortgages and mortgage-related instruments and by purchasing mortgages and mortgage-related loans. Commercial MREITs provide financing for commercial real estate, including, importantly, multi-family housing. They invest in commercial mortgages and commercial real estate loans, CMBS, mezzanine loans, subordinated securities or construction loans and participate in loan securitizations.<sup>2</sup>

Most large residential and commercial MREITs are SEC-registered (and therefore subject to the disclosure requirements of the securities laws) and listed on either the NYSE or NASDAQ. They efficiently raise private capital for single family and multi-family housing without reliance on federal guarantees or insured deposits. MREITs raised \$88.2 billion in total equity offerings between 2005 and March 2017. As of May, 2017, there were 25 listed residential Mortgage REITs with an equity market capitalization of \$47.3 billion and 14 listed commercial MREITs with an equity market capitalization of \$16.1 billion.<sup>3</sup>

MREITs hold mortgages and MBS on their balance sheets and fund these investments with a variety of sources, including common and preferred equity, repurchase agreements, structured financing, convertible and long-term debt, and other credit facilities. MREITs typically use less borrowing and more equity capital to finance their acquisitions of mortgages and MBS than do other large mortgage investors. At December 31, 2016, the asset-weighted average equity capital ratio of all stock exchange-listed MREITs was 15.1 percent, compared to 9.5 percent for the commercial banking industry and 7.5 percent for the investment banking industry. MREITs were also typically better capitalized than other mortgage investors in the period before the 2008 financial crisis.

---

<sup>1</sup> The National Association of Real Estate Investment Trusts (NAREIT) is the worldwide representative voice for real estate investment trusts (REITs) and publicly-traded real estate companies with an interest in U.S. real estate and capital markets. NAREIT's members are REITs and other real estate businesses throughout the world that own, operate and finance residential and commercial real estate. See [www.nareit.com](http://www.nareit.com).

<sup>2</sup> For more information about MREITs, See <http://www.reit.com/investing/reit-basics/guide-mortgage-reits>.

<sup>3</sup> Listed REITs focusing on the ownership and operation of apartments, manufactured housing, student housing, senior housing and single family housing rentals supply significant capital from the public markets to meet housing needs of the country. As of May 31, 2017, the equity market capitalization of REITs specializing in apartments, manufactured housing, student housing and single family homes was \$143,871,058. See, [REITWatch](#), *supra note 1* at 4.



## ***Residential MREITS and U.S. Housing Finance***

Residential MREITs stand today as one of the very few significant wholly private sources of permanent capital dedicated to the single-family housing sector, contributing to housing affordability by financing mortgage loans, purchasing mortgages and RMBS and providing first loss capital for new private label securitizations. Residential MREITs have, to date, financed mortgage loans for 2.5 million American homebuyers.

The success of residential MREITs today reflects years of developed expertise in the fundamentals of real estate debt markets: expertise combining rigorous research, valuation, data collection, underwriting and technical analytics, together with a deep understanding of the fiscal, legal and regulatory frameworks within which RMBS markets operate. As such, MREITs are well positioned to expand their role in the post-financial crisis restructuring of the U.S. housing finance market.

Residential MREITs (and some commercial MREITs) are real estate finance businesses created and operated for the very purpose of funding residential real estate. As such they are wholly aligned with the mission of the FHLBs. FHLB advances permit MREITs to expand beneficial housing finance activities and strengthen their balance sheets with an additional sources and durations of funding. Capital markets, rating agencies<sup>4</sup> and even the Financial Stability Oversight Council (FSOC) have acknowledged the benefits of FHLB participation.<sup>5</sup>

### ***The FHFA's FHLB Membership Rule and MREITs***

On Sept. 14, 2014, when the Federal Housing Finance Agency (FHFA) released its Notice of Proposed Rulemaking (NPRM)<sup>6</sup> to eliminate the Federal Home Loan Bank (FHLB) membership eligibility of insurance captives, at least five MREITs had become FHLB members via captive insurance subsidiaries and nearly two dozen others were exploring the option, many being aggressively recruited by FHLB executives and, as FHFA later noted, in some cases, by state insurance regulators.<sup>7</sup> Ultimately, more than 25 MREIT insurance captives became members of the FHLBs prior to the Jan. 20, 2016 publication of the FHFA's final FHLB membership rule (Final Rule)<sup>8</sup> that terminated the eligibility of captive members.

Upon the issuance of the NPRM, NAREIT's MREIT Council formed a FHLB task force which spent several months reviewing the proposed rule, the legislative history and relevant sections of

---

<sup>4</sup> See, e.g., Fitch Ratings, "Certain mREITs have established captive insurance subsidiaries in recent years as a means of gaining FHLB membership and improving the diversity, duration and cost of their funding... The future loss of FHLB system borrowings for mREITs incrementally weakens the diversification of their funding sources. (January 15, 2016), at <http://www.businesswire.com/news/home/20160115005710/en/Fitch-FHLB-Funding-mREITs-Good-Lasted>.

<sup>5</sup> FSOC, 2015 Annual Report at 75. The FSOC's 2015 Annual Report noted, "[s]ome agency REITs have taken further steps to reduce their rollover risk by seeking greater diversity in both the sources and the types of funding that they utilize, such as Federal Home Loan Bank (FHLB) borrowings"

<sup>6</sup> 79 Fed. Reg. 54848 (Sept. 12, 2014) (NPRM)

<sup>7</sup> See, e.g., Comments by the Ohio Department of Insurance, RIN 2590-AA39 (Jan. 15, 2015) at and Final Rule at 41.

<sup>8</sup> Members of Federal Home Loan Banks, 81 Fed. Reg. 3246 (Jan. 20, 2016). (Final Rule).

the 1932 FHLB Act and the FHLBs' current administration of the various rules governing the FHLB system, as well as assessing the recent experiences that some Council members have had with the FHLB system.

At the conclusion of its study, the MREIT Council did not agree with the FHFA that a valid legal or public policy rationale had been established to bar MREIT captive insurance subsidiaries from FHLB, nor that there was a compelling safety and soundness basis for such a radical rule change. Moreover, the Council had even greater conviction that MREITs are highly aligned with the housing mission of the FHLBs and that their participation in the FHLB system would benefit FHLB members. The Council's views were set forth in its Jan. 12, 2015 [Comment \(NAREIT Council Comment\)](#)<sup>9</sup> to the FHFA and in subsequent correspondence.<sup>10</sup>

The Council also embarked on a series of meetings to educate policy and lawmakers about the strong mission alignment between MREITs and the FHLB system and the valuable contribution that MREIT captive members can contribute to the FHLB system.

FHFA acknowledged receiving at least 400 comments directed at its proposal to eliminate captive insurance membership and that "60 of those letters treat[ed] the issue in some depth."<sup>11</sup> Nevertheless, on Jan. 20, 2016 FHFA published its Final Rule eliminating the eligibility of MREIT captives and terminating the current FHLB membership of most MREITs by Feb. 18, 2017.<sup>12</sup>

The sixty or so substantive comments objecting to the elimination of captive insurance FHLB membership that were submitted to FHFA in 2015 set forth detailed legal, policy and economic objections to the FHFA's Final Rule. Regarding MREIT captives specifically, several important points emerge from these comments and the FHFA's response, as reflected in preamble to the Final Rule:

- The FHFA does not dispute the strong mission alignment between MREITs and the FHLB system, acknowledging that the "FHFA agrees that mortgage real estate investment trusts (REITs) play an important role in the residential mortgage market..."<sup>13</sup> Dr. Michael Stegman, the Treasury Department's former Housing Counselor, also observed then that "many of the activities that REITs engage in appear to be aligned with

---

<sup>9</sup> Comment by the National Association of Real Estate Investment Trusts, RIN 2590-AA39 (Jan. 12, 2015) (NAREIT Council Comment).

<sup>10</sup> Oct. 13, 2016, NAREIT joined six other trade associations in submitting a [letter](#) to FHFA Director Melvin Watt requesting that the FHFA extend the one-year transition period applicable to most MREIT captive members. Director Watt responded in a Dec. 8, 2016 [letter](#), reiterating the FHFA's previous position that "Congress, not FHFA, should decide whether currently ineligible institutions should be eligible to avail themselves of the benefits of membership in a Federal Home Loan Bank..."

<sup>11</sup> Final Rule at 19.

<sup>12</sup> Five MREIT captives admitted prior to the rule's initial proposal were granted an additional 48 months. The majority of MREITs that became members of the FHLBs did so in 2015, together with several hedge funds, Business Development Companies (BDCs), mortgage banks, at least one foreign bank and one equity REIT.

<sup>13</sup> See Federal Housing Finance Agency, Final Rule, Federal Home Loan Bank Membership, Frequently Asked Questions available at [http://www.fhfa.gov/Media/PublicAffairs/PublicAffairsDocuments/FAQs-for-FinalRule\\_01-12-16.pdf](http://www.fhfa.gov/Media/PublicAffairs/PublicAffairsDocuments/FAQs-for-FinalRule_01-12-16.pdf) (Final Rule FAQs).

the FHLB System’s core mission, and represent an important source of private capital that should be at the core of the U.S. housing finance system.”<sup>14</sup>

- FHFA did not appear to base its decision to exclude MREITs on the policy or economic merits of MREIT FHLB membership. In the Final Rule, FHFA stated that its decision reflected its legal conclusion that granting MREITs FHLB membership eligibility would require congressional action, stating that this is “... is the type of public policy issue that is for Congress to address. By precluding ineligible institutions from gaining de facto membership through captive insurers, the final rule has the effect of preserving the decision of whether to allow REITs access to the Bank System for Congress to address, should it choose to do so.”<sup>15</sup>
- FHFA also expressed concerns about the potential misuse of the captive membership vehicle by *other--non-MREIT--non-eligible* entities, “FHFA is concerned that this practice will continue to grow and there is no reason to believe it will not grow to include entities other than REITs, such as hedge funds, investment banks and finance companies, some of which have already inquired about establishing captives to gain access to the FHLBank System.”<sup>16</sup>
- Without presenting analysis, FHFA rejected suggestions made by NAREIT’s MREIT Council and others that “...a variety of more targeted amendments to the FHLB membership rules could better accomplish the goals set forth in the NPRM without taking the radical step of discriminating among types of insurance firms and effectively proscribing the beneficial participation of mission-aligned MREIT captive insurance subsidiaries.”<sup>17</sup>
- All eleven FHLB Presidents supported continued FHLB membership for MREITs in comments submitted by the FHLB Presidents’ Conference<sup>18</sup> and separate letters submitted by each President<sup>19</sup> As one President stated (and others quoted):  
*Real estate investment trusts (REITs), particularly those investing in mortgage assets (Mortgage REITs, or MREITs), which in some cases are sponsors of captive insurance companies that borrow from the FHLBanks, are increasingly important participants in the mortgage market. Permitting continued access to captives sponsored by REITs,*

---

<sup>14</sup> Remarks by Counselor to the Secretary for Housing Finance Policy Dr. Michael Stegman before The North Carolina Bankers Association 2014 American Mortgage Conference (Sept. 9, 2014).

<sup>15</sup> Final Rule at 49.

<sup>16</sup> See Final Rule FAQs *supra*, note 15.

<sup>17</sup> See NAREIT Council Comment, “For example, if the FHFA’s concern is that FHLB advances to captive members could be misdirected to purposes unrelated to FHLB mission, the Council suggests that the FHFA might consider developing various membership criteria applicable to the parent of a captive member to ensure that the parent firms are mission-aligned and demonstrate requisite links to the housing finance and community development mission of the FHLB system. Alternatively (or additionally) if the FHFA wishes to ensure that the links between parent firms and their captive subsidiaries remain sufficiently robust to protect the FHLBs under a variety of scenarios, the FHFA could address this concern more directly and efficiently by developing standard guarantees for parent firms of captive FHLB member.”

<sup>18</sup> [Comment](#) by John E. Bowman, Esq. on behalf of the Council of Federal Home Loan Banks (Oct. 8, 2014).

<sup>19</sup> See, e.g., Comments by FHLB Presidents Matt Feldman (Chicago), Richard Swanson (Des Moines), Andrew Jetter (Dallas), Andrew Howell (Cincinnati), Cindy L. Konich (Indianapolis) Sanjay Bhasin (Dallas), Edward A. Hjerpe III (Boston), Jose R. Gonzalez (New York). W. Wesley McMullen (Atlanta), Winthrop Watson (Pittsburgh) Dean Schultz (San Francisco)

*including MREITs, and other housing-related entities, would assist in fulfilling the statutory mandate of the FHLBs and supporting the expansion of housing opportunity and liquidity in the United States*

- In July 2015, the FHLB Presidents' Conference, noting the positive benefits of MREIT membership for the financial health and stability of the FHLB system, submitted to FHFA a proposed framework for future captive membership and lending decisions, which was designed to insure “an appropriate nexus between the mission of the FHLBs and the captive insurance members, their sponsoring parents or affiliated companies...to maintain the safety and soundness of the System.”<sup>20</sup>
- The FHFA did not analyze the FHLB Presidents' proposed framework, or any of the alternative measures proposed in public comment. It also declined to address the economic consequences of its decision for the FHLB system. Its final decision to terminate MREIT captive membership appeared to rest on its reading of its authority under the existing statutory framework, “Regardless of the financial impact, which is unknown, FHFA cannot allow the Banks to continue to engage in activities that it has concluded are not authorized under the law.”<sup>21</sup>

### **Congressional Response**

During the 114<sup>th</sup> Congress, NAREIT's MREIT Council supported various legislative efforts to enable MREITs to become members of the FHLBs, including two bills in 2015 ([H.R. 3808](#)) and ([S. 1484](#)) that would have blocked implementation of the final FHFA/FHLB Membership Rule.

NAREIT's MREIT Council continues to strongly support efforts—legislative and regulatory—to enable qualified MREITs to become eligible for FHLB membership. To this end, on April 20, 2018, the Executive Committee of the MREIT Council responded to the request from Senate Banking Committee Chairman Mike Crapo (R-ID) and Ranking Member Sherrod Brown (D-OH) for proposals to “increase economic growth” with a [Comment](#)<sup>22</sup> urging the Committee to explore ways to address the “ineligibility of MREITs to become (and in a few cases remain) members of the Federal Home Loan Banks (FHLBs), following the Federal Housing Finance Agency's (FHFA) [2016 FHLB Membership Rule](#) (FHLB Membership Rule) disallowing captive insurance members.”

### **Conclusion**

NAREIT's MREIT Council would welcome the Treasury Department's support and engagement with the FHFA, Congress and others in efforts to develop a path—by rule-making or legislation—to enable qualified residential MREITs to become (and in some cases, remain) FHLB members, directly, or through a captive subsidiary, by rule-making or legislatively.

---

<sup>20</sup> *Id.*

<sup>21</sup> Final Rule at 67.

<sup>22</sup> Comment by the MREIT Council of the National Association of Real Estate Investment Trusts, (April 20, 2017).