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FHFA Pulls Captive Insurance Company FHLBank Eligibility

The **final rule** for membership in the Federal Home Loan Banking System (FHLBank) was announced on Tuesday by its regulator the Federal Home Finance Agency (FHFA). The new rule will eliminate one class of membership while deleting another requirement from the proposed rules announced in 2014.

The rule allowing insurers membership has been rewritten to define out those that meet the definition of "captive insurance companies." A captive insurer is one for which the primary business is underwriting insurance for its parent company or for other affiliates rather than for the public at large. FHFA said that such companies are generally easier and less expensive to charter, capitalize and operate and this type of entity is increasingly being used as a way to qualify **otherwise ineligible** companies from becoming FHLBank members. The captive insurance in effect become conduits to get low-cost FHLBank funding for the ineligible parent company. Since mid-2012 there have been 27 new captive insurers admitted to FHLBank membership, 25 of which are owned by otherwise ineligible entities.

FHFA is concerned that this practice will continue to increase 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.

Institutions that **do not** give rise to such concerns and that would be regarded as carrying out the business of insurance as traditionally understood will continue to be considered insurance companies for purposes of determining eligibility for FHLBank membership.

FHFA Director Melvin Watt said about the redefinition, "FHFA has the **authority and the duty** to implement the statutory membership provisions of the Federal Home Loan Bank Act and by adopting the proposal to exclude captives from the definition of insurance company we are making sure that institutions can't frustrate the intent of Congress. Congress has amended the Federal Home Loan Bank Act in the past to allow additional entities to become members of a Federal Home Loan Bank and it can certainly do so again if it wants some of these entities to be eligible for membership."

National Average Mortgage Rates

	Rate	Change	Points
Mortgage News Daily			
30 Yr. Fixed	7.09%	+0.07	0.00
15 Yr. Fixed	6.56%	+0.03	0.00
30 Yr. FHA	6.62%	+0.07	0.00
30 Yr. Jumbo	7.35%	+0.04	0.00
5/1 ARM	7.30%	+0.06	0.00
Freddie Mac			
30 Yr. Fixed	7.02%	-0.42	0.00
15 Yr. Fixed	6.28%	-0.48	0.00
Mortgage Bankers Assoc.			
30 Yr. Fixed	7.08%	-0.10	0.63
15 Yr. Fixed	6.61%	+0.01	0.65
30 Yr. FHA	6.89%	-0.03	0.94
30 Yr. Jumbo	7.22%	-0.09	0.58
5/1 ARM	6.56%	-0.04	0.66

Rates as of: 5/17

Recent Housing Data

		Value	Change
Mortgage Apps	May 15	198.1	+0.51%
Building Permits	Mar	1.46M	-3.95%
Housing Starts	Mar	1.32M	-13.15%
New Home Sales	Mar	693K	+4.68%
Pending Home Sales	Feb	75.6	+1.75%
Existing Home Sales	Feb	3.97M	-0.75%

		Value	Change
Builder Confidence	Mar	51	+6.25%

The final rule changed the proposed version to exclude a provision that would have required bank members to maintain ongoing minimum levels of investment in specified residential mortgage assets. Research found that 98 percent of members are currently in compliance with the requirement and FHFA concluded that enforcing the rule on the remaining 2 percent would be unduly burdensome. "The statutory requirements for members to continue their commitment to housing finance can be addressed by monitoring the levels of residential mortgage assets they hold and we, therefore, **decided not to include** the ongoing investment requirements in the final rule," Watt said.

To **minimize disruption** captive insurer members that joined prior to FHFA's proposed rule will be given up to five years to terminate their membership and those that joined after issuance of the proposed rule in 2014 will have one year to do so.

FHFA said it received more than 1,300 comment letters after publishing the 2014 proposed rule. The final rule will become effective 30 days from publication in the Federal Register. It also requires FHLBanks to obtain and review audited financial statements for insurance company applicants when considering them for membership and clarifies the standards for determining the location of an institution's "principal place of business" for purposes of identifying the appropriate FHLBank district for membership.

In a press release **David H. Stevens,** President and CEO of the **Mortgage Bankers Association,** expressed disappointment in the new rule. He said Congress, in establishing the membership framework of the FHLBanks, didn't limit membership to only certain insurance companies. "Today, without direction from Congress, FHFA decided to narrow membership and exclude important members of the system. In particular, FHFA's decision to disqualify captive insurance companies removes a vital component of the FHLBank membership which provides liquidity for the real estate finance market."

Stevens said that the market needs a system that serves the **wide variety** of lending institution active in housing finance " including captive insurance companies, REITs, independent mortgage bankers, and other entities, all of which provide major sources of liquidity and are core components in the 21st century FHLBank system."

In a **FAQ sheet** linked to the final rule FHFA said it agreed that mortgage real estate investment trusts (REITs) have an important role in mortgage markets. "However, concluding that channeling of low-cost FHLBank funding to REITs and other ineligible entities through captive members is not authorized by or consistent with the Bank Act, FHFA is compelled to put an end to that practice until such time as Congress authorizes that access."