COUNCIL OF FEDERAL
HOME LOAN BANKS

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FHLBANKS
A NATION OF LOCAL LENDERS

April 27, 2015

Mr. Gerard Poliquin
Secretary of the Board
National Credit Union Administration
1775 Duke Street
Alexandria, VA 22314-3428
Filed via: regcomments@ncua.gov

Re: Proposed Rule - Risk-Based Capital; RIN 3133-AD77

Dear Mr. Poliquin:

The Council of Federal Home Loan Banks ("Council"), appreciates the opportunity to comment on the above-referenced proposed rule (the "Proposed Rule") published by the NCUA in the Federal Register on January 27, 2015. The Council is an association whose members are the twelve Federal Home Loan Banks ("FHLBanks"). The Proposed Rule revises the NCUA's 2014 proposed rule entitled *Prompt Corrective Action – Risk-Based Capital* and addresses risk-based capital thresholds for complex credit unions. We appreciate the progress made in the Proposed Rule regarding risk-based capital thresholds and are encouraged that many of the concerns expressed by credit unions, FHLBanks and industry partners have been addressed. We also appreciate the Proposed Rule's recognition of the Mortgage Partnership Finance® ("MPF"®) Program as a unique secondary market outlet for conforming fixed rate residential mortgage loans that rewards FHLBank-member credit unions for quality underwriting, resulting in strong historic performance. While the provisions about the MPF Program in the Proposed Rule will provide more appropriate risk-based capital treatment for participating credit unions, we recommend several clarifications and revisions to ensure that certain provisions will not have unintended consequences for credit unions or the members and communities they serve.

The FHLBanks

The FHLBanks are government-sponsored enterprises of the United States, organized under the authority of the Federal Home Loan Bank Act of 1932, as amended, and structured as

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cooperatives. The primary mission of the FHLBanks is to provide liquidity to their members to facilitate housing finance and community development. They perform this mission as cooperatives serving nearly 7,400 member financial institutions, including more than 1,200 credit unions.

In furtherance of their mission, the FHLBanks established programs where they acquire conventional and government-insured residential mortgage loans from certain of their members, called Participating Financial Institutions ("PFIs"). In 1997, the Federal Home Loan Bank of Chicago began the MPF Program, which is today offered by most of the FHLBanks. Alternatively, the Federal Home Loan Banks of Cincinnati and Indianapolis have each established and independently operate a similar member product called the Mortgage Purchase Program ("MPP"). Both the MPP and MPF Program operate pursuant to Federal Housing Finance Agency regulation. The majority of PFIs that sell mortgage loans under these programs are small to mid-sized community banks, thrifts and credit unions.

Mortgage Partnership Finance Program Definition

We are concerned the Proposed Rule defines the "mortgage partnership finance program" in a manner that could result in an unintended consequence if the Proposed Rule is adopted as proposed. Such term is defined in the Proposed Rule as follows:

> "Mortgage partnership finance program means a Federal Home Loan Bank program through which loans are originated by a depository institution that are purchased or funded by the Federal Home Loan Banks, where the depository institutions receive fees for managing the credit risk of the loans *and servicing them*. The credit risk must be shared between the depository institutions and the Federal Home Loan Banks.[1]" (emphasis added)

Based on the emphasized language, the definition of "mortgage partnership finance program" could reasonably be construed to apply only to MPF Program loans that a credit union services. If the intent of the Proposed Rule is to treat all MPF Program loans the same regardless of whether the credit union retains or sells the servicing, then we recommend clarifying the definition by deleting the words "and servicing them" from the definition of "mortgage partnership finance program".

Exclusion of Mortgage Purchase Program from the Definition of MPF Program

Although the MPP and the MPF Programs are similar in many respects, there is an important difference regarding recourse risk. Credit unions retain recourse risk on MPF loans but not on

[1] *See*, definition of "mortgage partnership finance program", Re-Proposed Rule section 702.2, 80 FR at 4429-30.

MPP loans and, therefore, we recommend an additional clarification of the definition of "mortgage partnership finance program" so that MPP loans are not inadvertently included. Under the MPF Program, PFIs retain recourse risk through a credit enhancement obligation to the FHLBank for credit losses on certain loans. In contrast, under MPP, the FHLBank retains a portion of the loan purchase price and pays those funds to the PFI over time based on loan performance. This permits the loan sales to qualify for true sale accounting treatment. Thus, the MPF Program achieves credit enhancement by creating a contingent liability for PFIs while the MPP achieves credit enhancement by creating a contingent asset for the PFI. Under the MPP, the FHLBank has no other recourse to the PFI, other than under routine representation and warranty clauses standard for sales in the secondary market. The purpose of the risk-based capital requirements for off-balance sheet activities is to ensure credit unions hold capital against recourse risk. Because MPP loans do not carry recourse risk for credit unions, it stands to reason that MPP loans fall outside of the definition of MPF Program. Therefore, for clarity, we recommend adding the words "in a manner other than by establishing a contingent asset for the benefit of or payable to the depository institution" at the end of the definition of MPF Program. Doing so will ensure that loans sold under the MPP are not inadvertently included in the definition of MPF Program.

Risk Weights for On-Balance Sheet Assets

Credit unions play a vital role in furtherance of the FHLBanks' mission of supporting home ownership and strengthening communities. FHLBanks assist credit unions in a number of ways to provide their members access to mortgages while mitigating associated risks, namely interest rate risk. As a result, we are concerned that the high risk weights assigned to certain first-lien residential real estate loans and certain junior-lien residential real estate loans could negatively impact mortgage lending in the communities served by credit unions.

The Proposed Rule assigns a 75% risk weight to first-lien residential real estate loans with concentrations greater than 35% of total assets. Although the risk weight was reduced to 75% from the 100% in the original proposal, it remains elevated and significantly higher than the 50% risk weight applied by other federal banking regulatory agencies. Additionally, the 150% risk weight assigned to junior-lien real estate loans which comprise greater than 20% of total assets is markedly higher than the 100% risk weight applied by other federal banking regulatory agencies. Moreover, these provisions do not appear to address the underlying attributes of the mortgages nor the degree in which they may be match funded, which could thereby restrict lending and curtail profitability and capital growth at well managed, risk-averse credit unions. Therefore, we urge the NCUA to reconsider and revise the risk weights for mortgage loans held on balance sheet to be more consistent with requirements of other federal banking regulatory agencies.

Thank you for considering this comment letter. If you have any questions please feel free to contact John von Seggern at (202) 955-5737 or johnvon@cfhlb.org.

Sincerely,

John L. von Seggern
President and CEO
Council of FHLBanks