Federal
Home Loan
Bank
OF INDIANAPOLIS

Via Federal Express

January 29, 2003

Elaine L. Baker, Secretary
Federal Housing Finance Board
1777 F Street, NW
Washington, D.C. 20006

Re: Multidistrict Membership

Dear Ms. Baker:

The Federal Home Loan Bank of Indianapolis ("FHLBI") is filing the following comments with respect to the Federal Housing Finance Board's ("Finance Board") solicitation of comments regarding the consequences of ongoing changes in the financial services industry as requested in Resolution No. 2002-63 issued December 17, 2002.

Background

The two most significant changes in the financial services industry that have had, and will continue to have, an impact on the Federal Home Loan Bank System ("System") and the Federal Home Loan Banks ("FHLBanks") are the expansion of lending activities of various institutions nationwide and the continued merger and consolidation of institutions across FHLBank district lines. Due to the current rules governing FHLBank membership, FHLBanks either lose significant members when they are consolidated into an institution outside the FHLBank's district or end up with very large members with national operations and increased need for advances from just one FHLBank. The result is either a loss of significant income which decreases dividends and AHP funding due to the loss of members or an increase in market and operational risk due to a concentration of credit in a small number of very large member institutions.

The solutions that have been proposed to deal with these negative impacts on the FHLBanks include 1) rewriting the membership, advances and collateral rules to allow institutions to be members in more than one FHLBank district; or 2) requiring the use of loan participations between the FHLBanks where one FHLBank loses a member to another FHLBank - a portion of all future advances to the surviving member would have to be offered to the former FHLBank to allow it to recoup some of the lost income and advance activity they would have had if the member had not been removed from the FHLBank's district.

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Each of these proposed solutions has its own set of difficulties which will be discussed in more detail below.

Membership Rules

Allowing financial institutions to become members of multiple FHLBanks may appear to solve both the loss of member problem and the credit concentration issue fairly easily. However, multidistrict membership has significant problems, not the least of which is whether it can be legally accomplished under the current language of the Federal Home Loan Bank Act (the "Act"). The Act clearly states:

> An institution eligible to become a member under this section may become a member only of, or secure advances from, the Federal Home Loan Bank of the district in which is located the institution's principal place of business, or of the bank of a district adjoining such district, if demanded by convenience and then only with the approval of the Board.
> (12 U.S.C. §1424(b)).

Seventy years of operating history support this clear statutory mandate. Now a novel legal argument has been made that the Finance Board's duty to protect the safety and soundness of the System would allow it to redo the membership rules to permit multidistrict membership if that would reduce risks to the System. However, no regulator can pass regulations that directly conflict with the clear language of the regulator's enabling statute. The most that could be said about the Act is that a member might be able to be a member of two adjoining districts (and that is a stretch as the statute clearly uses "or" to mean a choice between the two districts), but it in no way would permit a member of the Seattle FHLBank, for example, to be a member of the Dallas FHLBank or the New York FHLBank.

Further, the Finance Board's own membership regulations, found at 12 C.F.R. Part 925, clearly demonstrates that membership was always intended to be in one FHLBank district only. Mergers or consolidations were anticipated and provided for in the law, which include provisions for changing the automatic transfer of membership between FHLBank districts if certain tests could be met by the member. Given the ramifications to our regionally based FHLBanks, any change in the clearly stated interpretation of the Act should occur with clear direction from the Congress.

Retroactive Application. If the Finance Board properly determines that it has the legal authority to institute multidistrict membership, such a change should be made retroactive. The FHLBI believes that, if multi-district membership is implemented, former FHLBank members that lost membership in a district due to

a merger or other consolidation should be permitted to reapply for membership in such district, even though the surviving entity does not maintain a charter in such district. Eligibility for membership would be subject to any other requirements that are imposed under a multidistrict membership rule, such as maintenance of a certain level of assets or borrowings in the district, collateral requirements, stock ownership and other factors.

Adoption of this retroactive membership provision should apply to all members that lost membership and still have a material business presence in the district. This would help put former and current members on an equal footing and would prevent any discriminatory treatment of those members that lost membership under the old rules when the idea of multidistrict membership was not contemplated.

Antitrust Issues. Assuming that the Finance Board does have the authority and decides to implement some form of multidistrict membership, significant coordination and cooperation among the FHLBanks on issues such as collateral sharing and advance pricing is necessary. As a result, the FHLBI believes that the Finance Board must confirm that such coordinated transactions are exempt from or will not violate the federal antitrust laws.

The FHLBanks have carefully reviewed this issue on various occasions and have conscientiously avoided any activities which arguably could come into question under the antitrust laws. However, the increased level of collaboration between the FHLBanks that would be needed in a multiple membership arrangement would extend beyond any level of coordinated or joint action that the FHLBanks have engaged in to date. The Finance Board must re-affirm that the FHLBanks, as government-sponsored enterprises and federal instrumentalities, are exempt from the federal antitrust laws, or alternatively enumerate which joint efforts required by multidistrict membership are exempt from the antitrust laws. The FHLBanks (even if considered private companies or persons) may still enjoy some antitrust immunity if they act pursuant to policies, programs or directives of the Finance Board. See, for example, Southern Motor Carriers Rate Conf. v. United States, 471 U.S. 48, 56-57, 105 S. Ct. 1721, 1726 (1985) and IT & E Overseas, Inc. v. RCA Global Communications, Inc., 747 F. Supp. 6, 11 (D.D.C. 1990), which held that private parties acting in compliance with clearly articulated government policies and programs are immunized from antitrust liability to the same extent as the government entity.

Service and Representation. Multidistrict membership also presents certain operating issues which need to be resolved. The member's "principal place of business," which is defined in the regulations as the institution's home state as established by the laws governing its organization (generally its charter state), determines a member's voting rights and affects director eligibility. In a multidistrict scenario, the member must either have multiple "principal places of business" not based upon home state location or some other factor must be used

to determine what state a member votes in or where elected directors must reside to be eligible for election. Further, questions must be answered concerning whether a member can have officers or directors serving as directors of more than one FHLBank and what confidentiality issues might be raised if one member, through multiple elected directors of different FHLBanks, has access to confidential or trade secret information that is not shared between the FHLBanks.

The FHLBI also believes that there should be no restrictions or limitations on the use of Affordable Housing Program funds based upon FHLBank or member geographic location. Any changes to the Finance Board's regulations should ensure that the Affordable Housing Program continues to be a nationally competitive program. The Finance Board would also have to address issues such as procedures for the FHLBanks to share collateral and the review of a member's community support obligations when they are members of multiple districts.

Member Affiliates. Any review of the membership rules should address the inconsistent treatment of members' non-bank affiliates. One trend in the financial services industry has been the creation by financial institutions of subsidiaries and affiliates such as mortgage companies, real estate investment trusts, securities holding companies and similar entities, that are not banks but perform many of the same functions. These are often formed to take advantage of state laws that favor corporations over financial institutions with respect to regulation, taxation, branching, and other matters. The Finance Board regulations treat these entities differently depending upon the product or service the FHLBank provides.

For example, FHLBanks may offer collection, settlement and payment processing services to any institution that is eligible to become a member of any FHLBank, regardless of whether the institution applies for or would be approved for membership (12 U.S.C. §1431; 12 C.F.R. Part 975). Because affiliates of members, like mortgage companies or securities holding companies, would not qualify as eligible institutions, such correspondent services cannot be provided to such affiliates, even though such services are provided to their related member and even though the FHLBank could provide such services, including securities safekeeping, to non-members not even located in the FHLBank's district. Considering that the FHLBank has more information about and more participation with a member and its affiliates than it would have with a non-member, it appears to the FHLBI that the risk of allowing affiliates of a member to make use of these services is much less than the risk of providing such services to non-members. Section 11(e) of the Act clearly provides the Finance Board with "such incidental powers as the Board shall find necessary" to carry out the Act's authorization of such correspondent services. FHLBI believes that this would include the ability to extend such services to affiliates of members, subject to reasonable rules and regulations.

Another inconsistency affecting affiliates of members has to do with the Acquired Member Asset regulation at 12 C.F.R. Part 955. While affiliates of members are specifically authorized to directly pledge their assets to secure advances made to the member under the Advances regulation at 12 C.F.R. §950.7, an FHLBank may only buy acquired member assets that were originated by an affiliate of a member through the member, 12 C.F.R. §955.2(b). This means that mortgage loans, for example, originated by a member's mortgage company must be transferred to the member before they can be sold to the member's FHLBank. Unfortunately, both federal and state laws contain restrictions which make the transfer of loans to a member cumbersome and in some cases, impossible to do.

For example, Regulation W of the Federal Reserve System (12 C.F.R. Parts 223 and 250), limits a bank from purchasing more than 50% of the loans originated by its affiliates. Further, the Federal Reserve has issued a proposed amendment to the regulation that could limit transfers even further by prohibiting the bank from purchasing loans from all its affiliates, in the aggregate, in excess of 100% of the bank's capital and surplus. This means the affiliates must find other places to sell their loans and the restriction of §955.2(b) is preventing them from selling the loans to the FHLBanks. Another example would be state laws that favor the creation of mortgage or securities affiliates to hold these types of assets. The advantages that members receive by creating these affiliates under favorable state laws, including tax savings, regulatory relief and limitations on corporate liability, are lost if the member is required to procure the assets from the affiliates before selling them to the FHLBank. This prohibits these members from participating in the acquired member asset programs of the FHLBanks which is having a detrimental effect on the FHLBanks' ability to expand the programs.

Loan Participations

The proposal to require loan participations between FHLBanks when a member merges or consolidates out of one district into another does not raise the legal authority question as does the multidistrict membership proposal. Loan participations between the FHLBanks are already authorized under the law (see 12 C.F.R. §950.25). The use of loan participations provides a valid alternative to multidistrict membership by meeting the funding needs of large national members without disrupting the FHLBank regional structure.

In order for a FHLBank to purchase a participation in a former member's advances, there must be capital to support the activity. However, a former member cannot buy stock in its old FHLBank. Therefore, either the FHLBank would have to acquire capital from other sources or a form of capital would have to be created that would count as total capital for the FHLBank but not be treated

as “stock” that the former member can not hold. This also raises accounting and regulatory issues for the members that would need to be resolved.

In addition to the capital issue, this option would also need to address collateral sharing and perfection between the FHLBanks, and their default rights and control of proceedings. In order to accomplish the goal of reducing credit concentrations, an FHLBank that gains a member (or assets of a merged member) should be required to offer participations to those FHLBanks that lost the member and its assets. In no event, however, should the rule require the losing FHLBanks to buy participations. The proposal should also address whether the required loan participation offers should be subject to limits depending upon whether the member maintains a business presence in the former FHLBank district or not and whether it makes any increases or decreases in such presence over time.

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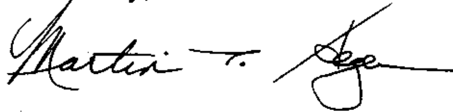
We thank you for the opportunity to provide comment on multidistrict membership and other options that the Finance Board may consider in its review. We also appreciate the willingness of the Finance Board to carefully address the numerous issues which affect the future of the FHLBanks and the members we serve.

Sincerely,



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