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1775 K Street NW
Washington, DC 20006

Federal Housing Finance Agency
400 7th Street, SW
Washington, DC 20024

<https://www.fhfa.gov/AboutUs/Contact/Pages/Request-for-Information-Form.aspx>

Re: FHLBank System at 100: Focusing on the Future

Thank you for the opportunity to submit comments on the mission of the Federal Home Loan Bank System under the policy review entitled, "FHLBank System at 100: Focusing on the Future". The question of clarifying the mission of the Federal Home Loan Bank System (the "FHLB System") comes at a critical time in the evolution of FHLB member insurance companies, as well as a period of crisis for the American dream of home ownership, a core mission of the FHLB System.

As private equity companies step up their acquisition of life insurers who are members of FHLBanks, the FHLB System is becoming a government-sponsored¹ piggy bank for a financial industry which has pioneered financial engineering and risk taking in many areas of the economy and which is underregulated at the firm level.

As private equity-owned insurers change the composition of their invested assets to increase riskier and illiquid products like collateralized loan obligations ("CLOs"), asset-backed securities ("ABS"), alternative investments, and related party investments, FHLBank funding agreements with such insurance members may expose the FHLB System to lower quality collateral or higher risks.

Moreover, it is unclear how private equity-owned insurers contribute to the core mission of the FHLB System of creating liquidity in housing finance to facilitate the goal of affordable housing or home ownership for individuals. For the approximately 1 million union members in the food and retail industries represented by the United Food and Commercial Workers International

¹ "However, the FHLBanks' status as a government-sponsored enterprise accords certain privileges and enables the FHLBanks to raise funds at rates slightly above comparable obligations issued by the U.S. Department of the Treasury." <https://www.fhfa.gov/SupervisionRegulation/FederalHomeLoanBanks/Pages/About-FHL-Banks.aspx>

Union, the American Dream of home ownership is often difficult to reach and escalating rents pose a daunting hurdle.

As the Federal Housing Finance Agency reviews the mission of the FHLB System, we urge you to critically analyze the role of private equity as members of FHLBanks and refocus the mission of the FHLB System and its members on facilitating individual home ownership and affordable housing for working families in America.

We offer an example of one private equity-owned life insurance member of the Federal Home Loan Bank of Des Moines – Athene Annuity & Life Insurance – to inform your reevaluation of the FHLB System’s mission.

Background on the Rise of Private Equity-owned Insurance Companies

Private equity firms are not by themselves eligible for membership in FHLBanks. One benefit to private equity firms of owning life insurance companies is that they gain access to the FHLBanks’ stable, low-cost source of capital as members of the government-sponsored banks in the FHLB System.² FHLBank members also benefit from dividends issued on their stock in the tax-exempt, and therefore taxpayer subsidized, FHLBanks.³

Private equity firms are increasing their investment in life insurance companies. According to McKinsey & Co’s February 2, 2022 article:

“All five of the largest private equity (PE) firms by assets have holdings in life insurance, representing 15 to 50 percent of their total assets under management. By our count, 15 alternative asset managers have entered the market, or stated their intent to do so.”⁴

When private equity firms own life insurers, they change the quality of invested assets, according to analysts Divya Kirti and Natasha Sarin in their 2020 publication, “What Private Equity Does Differently: Evidence from Life Insurance”:

“On the asset side, we show that PE parents make immediate and substantial changes to their subsidiaries’ bond portfolios. PE-backed insurance firms take on greater asset risk by moving out of highly rated corporate bonds and into poorly rated private-label

² <https://www.fdic.gov/resources/bankers/affordable-mortgage-lending-center/guide/part-3-docs/federal-home-loan-bank-system.pdf> p. 1: “However, the FHLBs’ status as a government sponsored enterprise enables the FHLBs to raise funds at rates slightly above comparable obligations issued by the U.S. Department of the Treasury.”

³ <https://www.sec.gov/ix?doc=/Archives/edgar/data/1325814/000132581422000031/fhlbdm-20211231.htm> Federal Home Loan Bank of Des Moines 10-K, p.4: “The Federal Home Loan Bank of Des Moines (the Bank, we, us, or our) is a federally chartered corporation that is exempt from all federal, state, and local taxation (except real property taxes and certain employer payroll taxes) and is one of 11 district FHLBanks. The FHLBanks are government-sponsored enterprises (GSEs) and were created under the authority of the Federal Home Loan Bank Act of 1932 (FHLBank Act) to serve the public by enhancing the availability of funds for residential mortgages and targeted community development.”

⁴ <https://www.mckinsey.com/industries/private-equity-and-principal-investors/our-insights/why-private-equity-sees-life-and-annuities-as-an-enticing-form-of-permanent-capital> 2/2/2022

asset-backed securities (ABS), increasing their holdings of private-label ABS by two-thirds of the industry average. Our data allows us to precisely pinpoint when these changes occur, and we show that PE parents modify their subsidiaries' portfolios within days of ownership changes."⁵

A 2021 analysis by the Federal Reserve Board's Research and Statistics Division, entitled "Are US Life Insurers the New Shadow Banks?", describes the structure of private equity-owned life insurers and reminds us of the role of the FHLBanks in the Credit Crisis of 2008:

"To grow their shadow banking business, the largest US life insurers developed a triangular organizational structure combining (i) a US-domiciled life insurance company with (ii) a Bermuda-domiciled captive reinsurer and (iii) an asset manager. First, the state-regulated insurance company sources relatively low-cost fixed rate insurance liabilities, such as fixed annuities. Second, the Bermuda-domiciled captive reinsurer assumes the mortality risk of the annuity liabilities. Annuity premiums are tax exempt in Bermuda and the corporate tax rate is about a third of what it is in the US. Third, the asset manager originates or purchases risky corporate loans. These assets are financed on- and off-balance sheet by the insurer's low-cost annuity liabilities. The combination of these three entities is the life insurers' new shadow banking business model."

"Runs on life insurers are like large unexpected adverse shocks to cash flows (Foley-Fisher, Narajabad & Verani 2019). During the financial crisis, runs on insurers forced them to scramble for liquidity from other sources, including FHLBs. In some cases, insurers required substantial government assistance to prevent spillovers to households and to the rest of the financial system."⁶

An example of this type of arrangement is Athene Annuity and Life Company ("Athene Annuity"), which is a private equity-owned life insurer that is a member of an FHLBank.

Athene Annuity's parent company, Athene Holding Ltd ("Athene"), is structured like the triangular structure described above. Athene is wholly owned by private equity firm Apollo Global Management, and "... substantially all of the existing deposits held and new deposits generated by Athene's US insurance subsidiaries are reinsured to its Bermuda reinsurance subsidiaries," according to Apollo's 10-Q for the period ending June 30, 2022.⁷ Furthermore, "As a result of its internal reinsurance structure and third-party direct to Bermuda business, a

⁵ Kirti, Divya and Sarin, Natasha "What Private Equity Does Differently: Evidence from Life Insurance," July 6, 2020, pp. 2-3. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3538443

⁶ Foley-Fisher, Nathan, and Verani, Stephane, "Are US Life Insurers the New Shadow Banks?", September 10, 2021, p.3, 27. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3534847

⁷ Apollo Global Management 10-Q Report to the Securities and Exchange Commission for the period ending 6/30/2022, p. 164 "Subject to quota shares generally ranging from 80% to 100%, substantially all of the existing deposits held and new deposits generated by Athene's US insurance subsidiaries are reinsured to its Bermuda reinsurance subsidiaries." <https://sec.report/Document/0001858681-22-000045/>

significant majority of Athene’s aggregate capital is held by its Bermuda reinsurance subsidiaries.”⁸

We explore the Athene example here because we believe the example raises larger questions about the mission of the government-sponsored FHLB System:

- Why is the government-sponsored FHLB System permitting low-cost capital to be provided to private equity-owned companies?
- Should the government-sponsored FHLB System provide low-cost capital to an insurance company which offshores “a significant majority” of its aggregate capital to related party reinsurers in Bermuda?
- Is a private-equity company’s reliance on asset-backed securities and structured assets in its investment portfolio good for the FHLB System?
- How is a private-equity backed insurer’s membership in an FHLBank benefiting a mission of housing finance and housing affordability?

Athene Example

Athene was founded by private equity firm Apollo Global Management and became a wholly owned subsidiary of Apollo on January 1, 2022. Athene’s subsidiary Athene Annuity and Life Company (“Athene Annuity”) is domiciled in Iowa and is a member of the Federal Home Loan Bank of Des Moines (“FHLB of Des Moines”).

FHLB of Des Moines Funding Agreements

According to Apollo’s most recent 10-Q, “Athene [Annuity] is a member of the Federal Home Loan Bank of Des Moines (“FHLB”) and, through its membership, has issued funding agreements to the FHLB in exchange for cash advances. As of June 30, 2022, Athene had \$3.0

⁸ Apollo Global Management 10-Q Report to the Securities and Exchange Commission for the period ending 6/30/2022, p. 104.

billion of FHLB funding agreements outstanding.”⁹ That amount has increased by 50% since December 31, 2020.¹⁰

At \$3 billion, funding agreements with Athene Annuity and its affiliates represented the fourth largest member borrowing of the FHLB of Des Moines.¹¹ According to FHLB of Des Moines’ June 2022 10-Q, “At June 30, 2022 and December 31, 2021, advances outstanding to our five largest member borrowers totaled \$17.5 billion and \$17.0 billion, which represented 33 percent and 39 percent of our total advances outstanding at each period end.”¹²

As a result, the FHLB of Des Moines has significant exposure to the quality of Athene Annuity’s collateral and the risk profile of Athene’s assets.

Athene’s Structured Asset Profile

According to Athene Holding’s (the parent “Athene”) 2Q 2022 Financial Supplement, Athene’s Net Invested Assets included 26.1% (\$49.3 billion) in asset-backed securities and other structured assets:

- 9.6% collateralized loan obligations (“CLOs”)
- 10.2% asset-backed securities (“ABS”)
- 6.3% alternative investments

By contrast, Athene had just 2.8% of its invested assets in safer government securities (federal, state, local and foreign). Importantly, just 8.5% of Athene’s net invested assets were classified as residential loans or residential mortgage-backed securities (RMBS), relevant to the core mission of the FHLB System.

⁹ Apollo Global Management 10-Q Report to the Securities and Exchange Commission for the period ending 6/30/2022, p. 137. “Athene is a member of the Federal Home Loan Bank of Des Moines (“FHLB”) and, through its membership, has issued funding agreements to the FHLB in exchange for cash advances. As of June 30, 2022, Athene had \$3.0 billion of FHLB funding agreements outstanding. Athene is required to provide collateral in excess of the funding agreement amounts outstanding, considering any discounts to the securities posted and prepayment penalties. Athene has a funding agreement backed notes (“FABN”) program, which allows Athene Global Funding, a special purpose, unaffiliated statutory trust, to offer its senior secured medium-term notes. Athene Global Funding uses the net proceeds from each sale to purchase one or more funding agreements from Athene. As of June 30, 2022, Athene had \$23.0 billion of FABN funding agreements outstanding. Athene had \$11.4 billion of board-authorized FABN capacity remaining as of June 30, 2022.”

<https://sec.report/Document/0001858681-22-000045/>

¹⁰ Athene Global Funding Shelf registration statement, dated 2/26/2021, p. 11: “funding agreements in the aggregate principal amount of \$2.0 billion outstanding to the Federal Home Loan Bank of Des Moines (the “FHLB”)” https://ise-prodnr-eu-west-1-data-integration.s3-eu-west-1.amazonaws.com/legacy/Supplements_da7796b8-938d-4c12-bc6c-ccdabb116b6b0.pdf

¹¹ Federal Home Loan Bank of Des Moines 10-Q filing with the Securities and Exchange Commission for the period ending 6/30/2022, p. 63.

<https://www.sec.gov/ix?doc=/Archives/edgar/data/1325814/000132581422000093/fhlbdm-20220630.htm>

¹² Federal Home Loan Bank of Des Moines 10-Q filing with the Securities and Exchange Commission for the period ending 6/30/2022, p. 63.

<https://www.sec.gov/ix?doc=/Archives/edgar/data/1325814/000132581422000093/fhlbdm-20220630.htm>

In 2021, the National Association of Insurance Commissioners issued a report entitled, “Private Equity-Owned U.S. Insurer Investments as of Year-End 2020” which compared the investments of private-equity owned insurers to all insurers:

“The second-largest bond investment for [private equity (“PE”)]-owned U.S. insurers at year-end 2020 was ABS and other structured securities at 25% of total bonds, representing a decrease from 27% of total bonds at year-end 2019.... Compared to all U.S. insurers, ABS and other structured securities’ investments for PE-owned insurers was significantly higher, as all U.S. insurers’ exposure to ABS was approximately 10% of total bonds at year-end 2020 (\$457.8 billion) and 9% of total bonds at year-end 2019 (\$410.5 billion).

“...The trend of higher ABS and other structured securities, and private label RMBS [residential mortgage-backed securities] exposure among PE- owned insurers (in terms of BACV [book/adjusted carrying value]), demonstrates a higher concentration of nontraditional bonds held by PE-owned insurers and, perhaps, the potential for increased volatility and risk. While PE-owned insurers have demonstrated a larger concentration of these nontraditional bond investments, the overall U.S. insurance industry has had a higher concentration of municipal bonds and U.S. government securities, which tend to carry less credit risk than the aforementioned, nontraditional bond types.”¹³

To illustrate the potential risks in these types of investments, just in the last month, the *Wall Street Journal* reported that the CLO market faced “‘the heaviest selling pressure we’ve ever seen,’ said Tom Majewski, managing partner at Eagle Point Credit Management, a Greenwich, Conn.-based investment firm specializing in CLOs.”¹⁴ The unexpected crash in the U.K. currency and government bond market caused margin selling of CLOs, causing prices to decline “to their lowest levels since May of 2020.”¹⁵

As noted earlier, Athene has \$18.2 billion of CLOs, or 9.6% of invested assets as of 2Q 2022, whose value could be subject to unanticipated market risks.

Athene is Largest Issuer of Funding Agreement-Backed Notes

Separately, Athene is also the largest issuer of funding agreement-backed notes (“FABN”), according to a Fitch Ratings report dated February 18, 2022, issuing \$11.4 billion worth in 2021. Fitch Ratings noted that FABN are sensitive to interest rates: “Additionally, FABNs exhibit

¹³ Johnson, Jennifer and Carelus, Jean-Baptiste, “Private Equity-Owned U.S. Insurer Investments as of Year-End 2020,” NAIC Capital Markets Special Report, July 16, 2021, p.3. <https://content.naic.org/sites/default/files/capital-markets-special-report-private-equity-owned-2020.pdf>

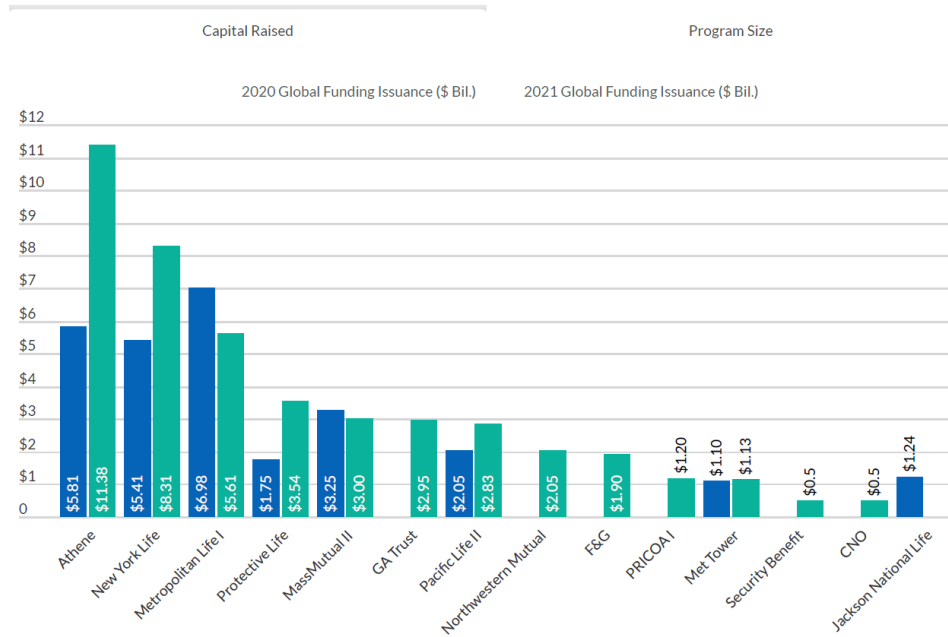
¹⁴ <https://www.wsj.com/articles/u-k-crisis-spills-into-u-s-junk-debt-11665440122> 10/11/2022

¹⁵ <https://www.wsj.com/articles/u-k-crisis-spills-into-u-s-junk-debt-11665440122> 10/11/2022 “CLO prices have dropped to their lowest levels since May of 2020, according to an index of the securities operated by Palmer Square Capital Management. The firm’s investment-grade CLO bond index traded at 88.7 last week, down 4% since the start of September.”

sensitivity to movements in both credit spreads and interest rates.”¹⁶ Since January 2022, U.S. interest rates have risen from 0.15% to 3.15% as measured by the Federal Reserve rate¹⁷, rising at one of the fastest rates in decades.¹⁸

Funding Agreement Backed Notes Issuance

Issuance of \$44.9 Bil. in 2021 Increased by 63% from 2020 Issuance of \$27.6 Bil.



Note: Pacific Life Short Term Funding, LLC and Brighthouse Financial Short Term Funding, LLC had no issuance in 2020 or 2021.
Source: Fitch Ratings.



According to Apollo’s June 30, 2022 10-Q:¹⁹

¹⁶ <https://www.fitchratings.com/research/insurance/us-life-insurers-robust-fabn-issuance-to-continue-in-near-term-18-02-2022> “US Life Insurers’ Robust FABN Issuance to Continue in Near Term”, Fitch Ratings, 2/18/2022

¹⁷ Federal Reserve Board: January 26, 2022 statement raises interest rate to 0.15% and September 21, 2022 statement raises interest rate to 3.15%.

<https://www.federalreserve.gov/newsevents/pressreleases/monetary20220126a1.htm>

<https://www.federalreserve.gov/newsevents/pressreleases/monetary20220921a1.htm>

¹⁸ <https://www.wsj.com/articles/fed-raises-interest-rates-by-0-75-percentage-point-for-third-straight-meeting-11663783397> “They are now raising rates at the most rapid pace since the 1980s and have approved increases at five consecutive policy meetings, starting in March when they lifted the fed-funds rate from near zero. Until June, the Fed hadn’t raised rates by 0.75 point since 1994.”

¹⁹ Apollo Global Management 10-Q Report to the Securities and Exchange Commission for the period ending 6/30/2022, p. 90 <https://sec.report/Document/0001858681-22-000045/>

“Athene [Holding, the parent company,] has a funding agreement backed notes (“FABN”) program, which allows Athene Global Funding, a special purpose, unaffiliated statutory trust, to offer its senior secured medium-term notes. Athene Global Funding uses the net proceeds from each sale to purchase one or more funding agreements from Athene. As of June 30, 2022, Athene had \$23.0 billion of FABN funding agreements outstanding. Athene had \$11.4 billion of board-authorized FABN capacity remaining as of June 30, 2022.”

In the wake of rising interest rates, in September, Athene bought back at a discount FABN notes it had issued, meaning the notes were valued at less than face value. In what the company describes as a “first-of-its-kind tender offer for a Funding Agreement Backed Note”,²⁰ Athene paid \$918.07 per \$1,000 face value to buy back \$260.1 million of its FABN 3.205% Senior Secured Medium-Term Notes due March 2027, at 8% lower than face value. Athene paid \$878.41 per \$1,000 face value for \$238.1 million of its FABN 2.450% Senior Secured Medium-Term Notes due August 2027, 12% lower than face value.

To the extent, if any, that Athene holds FABN notes on its life insurance books, Athene’s below face-value tender offer suggests the value of some of those assets has declined.

Additionally, Apollo notes in its second quarter 2022 earnings release that funding agreements and FABN notes had “slowed” for the quarter. Rising interest rates could continue to reduce the issuance of new funding agreement backed notes, lowering what has been a significant source of capital for Athene. In 2021, funding agreements and FABN notes generated 32% of Apollo’s capital inflow, according to the same second quarter 2022 earnings release.²¹

In the context of your mission review for the FHLB System, we urge you to study FABN’s and whether they expose FHLBanks to risk. Here, Athene’s large issuance of FABN notes and a potential reduction of that source of capital to Athene may expose the FHLB of Des Moines to risks, given Athene Annuity’s outstanding funding agreements with and membership in the bank.

Athene’s Tech Venture Investment

Another example of private equity firms’ appetite for risk is Athene’s sizeable investment in Softbank Vision Fund II. In its June 30, 2022 10-Q, an \$816 million investment in this technology venture fund was on Apollo’s list “...represent[ing] Athene’s investment concentrations in

²⁰ “Athene Holding Ltd. Announces Expiration and Results of Tender Offers by Athene Global Funding” September 13, 2022. [https://irathene.g4cdn.com/886888837/files/doc_news/2022/09/AGF-Tender-Offer-Press-Release-Expiration-\(9.12\).pdf](https://irathene.g4cdn.com/886888837/files/doc_news/2022/09/AGF-Tender-Offer-Press-Release-Expiration-(9.12).pdf)

²¹ 2Q 2022 Apollo Global Management earnings release, p. 13 <https://www.apollo.com/~media/Files/A/Apollo-V3/press-release/2022/earning-release-2q-2022.pdf>

excess of 10% of shareholders' equity."²² Softbank's Vision Fund arm posted \$50 billion in losses in the first half of this year.²³

We urge you to understand the FHLB System's exposure to private-equity style investments and whether such investments are being used as collateral for funding agreements with FHLBanks. Here, it may be relevant to learn whether Athene's Softbank investment is collateral for Athene Annuity's funding agreements with the FHLB of Des Moines, or whether it was acquired from an Apollo affiliate.

"Eating our own cooking"

In studying Athene's use of structured and asset-backed investments, we urge you to consider the issue of related-party transactions, particularly of a private-equity company using one subsidiary to issue asset-backed securities that a related subsidiary buys as an invested asset. For example, Athene reported that it has a practice of originating issuance of asset-backed securities in one set of Athene subsidiaries, and then buying those asset-backed securities as invested assets for Athene's insurance products.

In Barclay's recent investor conference this past September, Apollo's Chief Financial Officer Martin Kelly describes what is unique about its business model, ultimately concluding "It's sort of eating your own cooking."²⁴

"Being able to control the production of interesting products that creates differentiated returns is one of the key successes that Athene has had a higher ROA than its peer set over the last decade."²⁵

Mr. Kelly explained how:

"...[T]he merger between Apollo the asset manager and Athene has created a massive benefit. In this portfolio of capital - the assets to fund acquisitions - is focused on one of two things: One is buying more platforms, consumer and commercial origination platforms which create product which can then be used to be put in senior form back on Athene's balance sheet or

²² Apollo Global Management 10-Q Report to the Securities and Exchange Commission for the period ending 6/30/2022, p. 73. "The following represents Athene's investment concentrations in excess of 10% of shareholders' equity: ... Softbank Vision Fund II, \$816 million".

<https://www.sec.gov/Archives/edgar/data/1858681/000185868122000045/apo-20220630.htm>

²³ Reuters, 9/14/22 <https://www.reuters.com/business/finance/softbank-considering-launching-third-vision-fund-wsj-2022-09-14/> "SoftBank Chief Executive Masayoshi Son last month said he would restructure the Vision Fund investment arm after it reported a \$50 billion loss in the six months through June, as the value of its portfolio slid." Financial Times, 9/29/22 <https://www.ft.com/content/204c5d76-f55c-405c-b17a-be61f1a083f8> "SoftBank has laid off 30 per cent of staff at its flagship Vision Funds as the Japanese investment group seeks to dramatically cut costs after suffering record quarterly losses in a severe market rout for tech."

²⁴ Barclays 2022 Financials Conference, 9/13/2022, webcast on Apollo Global Management's website, minute 23:35 https://event.webcasts.com/starthere.jsp?ei=1569268&tp_key=f2e67bcda6&language=en-us

²⁵ Barclays 2022 Financials Conference, 9/13/2022, webcast on Apollo Global Management's website, minute 17:45 https://event.webcasts.com/starthere.jsp?ei=1569268&tp_key=f2e67bcda6&language=en-us

allocated to third party accounts or syndicated to the market. So it's a management fee or transaction fee or both business."²⁶

Athene's business model reflects many of the changes in practices outlined by analysts who have studied private equity-owned insurance companies, and it adds the element of related-party transactions, namely "eating your own cooking".

Recommendations

We believe the Athene example can inform the policy review, "FHLBank System at 100: Focusing on the Future", as a case study in how private equity ownership of life insurance companies can change the nature of FHLB System membership and potential risk.

We make the following recommendations:

- The FHLB System should facilitate home ownership and affordable housing for working families in America. As such, members in the System should be required to maintain substantial operations to support that goal, in exchange for access to government-sponsored capital.
- Private equity-owned companies should not be eligible for membership in the FHLB System, given the lack of regulatory oversight of private equity at the parent company level and a higher tolerance for risk.
- Financial institutions with substantial foreign operations should not be eligible for membership in the FHLB System.
- Insurers who reinsure a majority of their liabilities through captive reinsurers in foreign countries should not be eligible for membership in the government-sponsored FHLB System, given taxpayer-subsidized access to capital²⁷ and the potential for weaker regulatory regimes outside the U.S.
- The FHLB System should reduce risk in the U.S. financial system by establishing guidelines for members on acceptable levels of asset-backed securities and collateralized loan obligations in their investment portfolio.

Sincerely,



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²⁶ Barclays 2022 Financials Conference, 9/13/2022, webcast on Apollo Global Management's website, minute 15:00 https://event.webcasts.com/starthere.jsp?ei=1569268&tp_key=f2e67bcda6&language=en-us

²⁷ FHLBanks are exempt from federal, state and local taxes and they distribute profits to members in the form of dividends. Members also have access to lower than market funding through the System.