July 15, 2024

Director Sandra L. Thompson
Federal Housing Finance Agency
Constitution Center
400 Seventh Street, SW
Washington, DC 20024

Re: Request for Input on Federal Home Loan Bank Core Mission Activities and Mission Achievement

Dear Director Thompson:

Thank you for undertaking a timely and necessary review of the Federal Home Loan Bank System ("FHLB" or "System") and issuing a Request for Input on its mission. The United Food and Commercial Workers International Union represents 1.3 million workers in the grocery, retail, meatpacking, food processing, and related industries who have a fundamental need for affordable housing.

Millions of workers in these industries face a worsening housing crisis, which increasingly puts necessities out of reach, while the $1.3 trillion FHLB System has become focused on subsidizing profits for private financial companies, instead of financing affordable housing as originally intended.

Given a federal tax subsidy valued at $6.9 billion annually[1] and the urgency of our nation's housing crisis, we urge the Federal Housing Finance Agency to clarify that the FHLB's mission is to provide liquidity <u>for</u> affordable and equitable housing and that <u>all</u> System resources should be devoted to that mission.

We offer one example in the retail industry that concretely illustrates what is wrong with the FHLB System today, and we have prepared recommendations below which we believe will redirect the core functions of the FHLB System toward a renewed affordable housing mission.

Cardenas Markets, Apollo, and the FHLB

Retail workers at Cardenas Markets, an Ontario, California-based grocery chain, exemplify FHLB's mission drift.

Some workers at Cardenas Markets earn $17.50 per hour, or $35,000 a year if they get full-time hours. The National Low-Income Housing Coalition estimates Fair Market Rent for a 2-bedroom apartment in the Riverside area costs $1,751 per month.[2] A Cardenas worker earning $35,000 annually would pay 60% of her pre-tax income for that rent, an unsustainable expense. The Riverside Metro area, which includes Ontario, also had the highest rate of households unable to afford usual expenses in a recent Census Bureau survey of the largest US metro areas.[3]

Meanwhile, Cardenas Markets' owner, Apollo Global Management, is profiting from the FHLB System through another arm of its private equity empire. Apollo owns Athene Annuity and Life Company ("Athene Annuity"), the second largest borrower of the FHLB of Des Moines, with $7.6 billion in outstanding advances as of the end of March 2024.[4] Apollo discloses that Athene's FHLB advances are taken as part of an "investment spread strategy."[5]

So, while Apollo's portfolio company Cardenas Markets contributes to workers' inability to afford housing, Apollo's insurance company borrows from the FHLB System to boost its investment profits.

Insurance companies use FHLB loans to boost investment profits

Investment spread strategy means using FHLB loans as a cheap source of capital to boost company profits. A primer from the National Association of Insurance Commissioners (NAIC) explains that insurers are using FHLB advances for "…financial leverage (i.e., spread investment). [T]hey borrow funds at a relatively low rate from FHLB and invest in higher yielding assets, thus generating income off the spread."[6]

FHLBs offer insurance companies and other borrowers lower interest rates than commercial lenders due to their unique tax and regulatory exemptions and an "implied federal guarantee" of the FHLB System. The Congressional Budget Office recently estimated that the System's status as a government-sponsored enterprise lowered borrowing rates for FHLBs by 40 basis points (0.4%).[7] This subsidy is mainly passed on to its members as low interest rates and attractive dividends.

Insurance companies and other members buy FHLB stock in proportion to their borrowings, earning them dividends that further reduce already low interest rates.[8] In 2023, FHLB issued dividends of $3.4 billion to members.[9] By borrowing around 20% of FHLB's overall advances, it is reasonable to estimate that insurance companies earned $680 million in dividends in 2023 in addition to borrowing at below-market rates.

Industry publications and regional FHLBs also advertise how insurance companies can financially benefit from FHLB membership. For example, Wellington Management, which advises companies on investment strategies, promotes FHLBs on its website as "an opportunity for US insurers to enhance investment yield and total return."[10] Likewise, the FHLB of Chicago advertised membership to insurance companies as providing "access to a reliable funding source for spread investing strategies, with low rates that reflect our status as a government-sponsored enterprise (GSE)."[11]

This focus on optimizing profitability for FHLB members, without a clear connection to affordable housing, is yet another example of how FHLBs have strayed from their mission.

Missing from NAIC and Wellington's reports is any mention of housing use of proceeds, such as insurers leveraging FHLB funding to invest in affordable housing finance or development.

Further, while they borrowed 20% of all FHLB's advances, insurance companies make up just 9% of the overall membership,[12] demonstrating the extent to which insurance companies play an outsized role in borrowing from the FHLB System. Their share of advances borrowed grew explosively from less than one percent in 1997 to 19 percent of outstanding advances in the first quarter of 2024, making them the second-largest users of advances after commercial banks.[13] One-fifth of advances went to insurance companies, equal to $147 billion in advances, virtually all of that borrowed by life insurers.[14]

Current collateral requirements for FHLB borrowings do not suffice to steer proceeds of such advances to affordable housing. When the FHLB System was founded in the Great Depression, collateral to borrow from FHLB was limited to home mortgages secured by real estate valued under $20,000, drawing a straight line between FHLB borrowing and housing finance.[15] Insurance companies were originally permitted as members of FHLBs because they made residential mortgages. In 1930, insurance companies were responsible for 15% of all outstanding residential mortgages in the US.[16] However, changes in the mortgage industry meant that insurers were quickly not major players in the housing market. Even though they retained their ability to become members, strong collateral requirements ensuring that FHLB advances were tied to mortgages with maturity and dollar limits meant that insurance companies did not take advantage of the System for much of FHLB's history.

Only after Congress expanded eligible collateral to any real estate-related asset in 1989[17] did insurance companies see an opportunity to use advances for investment arbitrage. Now, permissible collateral includes any real estate-related assets, residential or commercial, and government securities.[18]

Insurance companies often put up mortgage-backed securities (MBSs) as collateral. Given the $10 trillion size of the US residential MBS market, the roughly $311 billion in RMBS held by the overall insurance industry is small, just 3 percent: equal to the daily trading volume in this highly liquid market.[19] We believe that owning RMBS to pledge as FHLB collateral is not additive in the housing finance market nor evidence of mission support for affordable housing, because the RMBS market is so liquid and already dominated by other government-sponsored enterprises, namely Fannie Mae, Freddie Mac, and Ginnie Mae.

We do not believe that allowing RMBS or other non-residential securities as eligible collateral contributes to mortgage affordability or housing supply. Therefore, our recommendation below is to require collateral equal to the amount of FHLB advances that meet a revised mission of financing affordable housing, excluding RMBS.

Just as changes to eligible collateral caused the drift from FHLB's housing mission, stricter collateral requirements are the best way to steer the System back onto its housing mission. The story of insurance company borrowing demonstrates the need for FHFA to use its regulatory authority to require mission-based collateral for advances in order to redirect the bulk of FHLB lending back to affordable housing.

Offshore Concerns

Athene Annuity also exemplifies another issue for the FHLB System: offshoring of capital and funding agreements to repay advances. Athene Annuity and Athene Annuity & Life Assurance, both members of the FHLB of Des Moines, are wholly-owned subsidiaries of Bermuda-based Athene Annuity Re Ltd (AARe),[20] which is in turn owned by Apollo's insurance unit, Athene Holding Ltd. Apollo disclosed at the end of 2023 that a "significant majority of Athene [Holding Ltd.]'s aggregate capital is held by its Bermuda reinsurance subsidiaries."[21] If much of Athene Annuity's capital is held by its Bermuda parent company, then arguably the benefit of borrowing from FHLB of Des Moines is accruing in large measure to a Bermuda company.

Moreover, Athene Annuity says that its FHLB funding agreements (agreements to repay FHLB advances) are "ceded" to Bermuda-based AARe "under modified coinsurance reinsurance agreements," according to financial statements filed with the Iowa Insurance Division.[22] The ceding of FHLB funding agreements to a Bermuda company raises questions about what would happen to the FHLB of Des Moines's loan if Athene Annuity did not repay it. Is it possible that FHLB of Des Moines may have to pursue enforcement of Athene's funding agreement in Bermuda court, if a Bermuda parent company asserts claims under the modified coinsurance reinsurance agreement?[23] We urge FHFA to understand if, and to what extent, FHLB funding agreements are being ceded to foreign-based reinsurers by insurance company members and what the legal ramifications are for repayment enforcement. This point is even more relevant given doubts about the FHLB's "superlien" on insurance member borrowings, articulated below.

Beyond Athene, other examples of foreign-owned members include Forethought Life Insurance, Accordia Life, and American National Life, who also have Bermuda-based parent companies, and the state-owned Industrial and Commercial Bank of China.

In addition to supporting affordable housing more directly, benefits of the taxpayer-subsidized FHLB System, such as capital or investment profit, should not accrue to foreign parent companies, and therefore, we do not believe foreign-owned companies should be permitted to borrow from the System.

McCarran-Ferguson vs. FHLB Superlien

Insurance firms may pose a unique concern to FHLB's "superlien" because of the interplay between state and federal law with respect to insurance. Under Section 10(e) of the FHLBank Act, FHLBs are granted a super-lien, which grants the FHLBs priority claims over the debt of their members. However, the FHLB of Boston disclosed in its 2022 10-K that "our security interests under Section 10(e) may not apply when lending to insurance company members due to the anti-preemption provision contained in the McCarran-Ferguson Act."[24]

The referenced provision in McCarran-Ferguson prevents federal law from superseding any state insurance law unless the federal law expressly regulates insurance.[25] Because the relevant provision of the FHLBank Act does not explicitly regulate insurance companies, there is a risk that the superlien does not apply to them. Therefore, FHLBanks' ability to perfect their interests in insurance members' debt or collateral may be contingent on state law.

In a letter to the Federal Deposit Insurance Corporation, the Council of Federal Home Loan Banks said that 27 states and two territories have given FHLBanks "equivalent state law collateral protections for insurance company members."[26] It is unclear whether state law offers equivalent protections for FHLB lending to insurers in those 27 states, and the Council's statement still leaves almost half of states where such protection apparently does not exist.

We encourage FHFA to study the extent to which the System is exposed to the added risk posed by McCarran-Ferguson's effect on the "superlien" when it comes to insurance borrowings and implement rules requiring higher interest rates from insurance borrowers to compensate for any such risk.

Answers to RFI Mission Questions

Mission Question One: How should the mission statement for the FHLBanks reflect the connection between the liquidity provided by the FHLBanks and their support for housing and community development?

1. We recommend revising the FHLB's mission statement to state: The mission of the FHLBanks is to provide liquidity *for* unmet credit needs for affordable and equitable residential housing and community development through lending to members for this public purpose. All of the FHLBanks' resources should further this mission, consistent with sound credit management, with appropriate exceptions for small member institutions for whom general liquidity is a critical need.

   The FHLBanks should fulfill this mission by addressing unmet credit needs in affordable and equitable housing and community development, aimed at low- and moderate-income households and households of color, especially those residing in underserved urban, rural, and Native Trust communities. They should accomplish this mission through:

   a. Extending advances to member institutions to expressly finance affordable and equitable housing and support community development investments that benefit these households and underserved communities.
   b. Using FHLBanks' balance sheets and excess capital that exceeds regulatory capital requirements to support and provide liquidity for affordable and equitable housing and community development in underserved markets.
   c. Offering direct financial support to subsidize affordable first-generation homeownership opportunities and affordable rental housing and community development projects that benefit low- and moderate-income households and households of color in underserved communities, over and above Affordable Housing Program contributions.

Measurement Question Three: In developing multiple measurements, what additional aspects of mission achievement should FHFA assess? What additional measurements should FHFA adopt to assess support for housing and community development, including support for lower income households or other groups with identified needs?

b.) Should all FHLBank advances count as core mission activities, or should there be limits or exclusions for advances (or other activity) involving members that have only a limited connection to housing and community development? How might this be measured? Should the type of collateral securing an advance be considered in evaluating advances? (Alternatively, this type of approach could be used for calculating one or more additional measurements.)

2. As the primary activity of FHLBs is making advances to members, we believe advances must be directly used for affordable and equitable housing and community development needs. Therefore, we urge FHFA to require collateral for advances that reflect a revised mission for FHLB, that is, assets serving unmet credit needs in affordable and equitable housing and community development. We propose that collateral backing advances be bifurcated to ensure mission use of advance proceeds: (1) strict "mission collateral" equal to the amount of advances, excluding highly liquid RMBS and other non-residential loans, and (2) "risk collateral," such as commercial and residential MBS or other allowable real estate and government loans providing liquid security to satisfy FHLB's risk and liquidity needs. FHFA should define "mission collateral" to appropriately align advances with the FHLB's revised mission.

3. We also recommend amending the definition of "long-term advances," which must be used for housing finance by statute, in order to tie proceeds of member borrowings to unmet credit needs in affordable and equitable housing directly. Rules like these could aim more of the lending power of FHLBs to its housing mission:
    a. We agree with your report proposing to define "long-term advances" as greater than 1 year maturity, down from 5 years, to increase the portion of FHLB lending serving its housing mission.
    b. Additionally, we propose strengthening the "proxy test" used to prove that long-term advances meet the statutory requirement by considering only mission-specific housing assets,[27] defined similarly to which assets count as "mission collateral" as discussed above.
    c. We propose to exclude small banks, community financial institutions, and community development financial institutions (CDFIs) from these stricter borrowing terms to preserve their access to FHLB liquidity.

4. Central to measuring the mission use of FHLB advances is the need for public disclosure of member borrowing on a reasonable schedule. We propose adopting standards of disclosure similar to borrowing from the Federal Reserve Discount

Window. We believe disclosure will encourage mission use of advances by members, provide accountability to FHLB's public purpose, and support FHFA's goal to "Ensure FHLBanks are not the Lender of Last Resort"[28] by bringing transparency to member borrowing on par with Federal Reserve.

<u>**Measurement Question Five**: Are there other approaches FHFA should consider?</u>

5. We urge you to consider rulemaking that would prevent foreign-owned entities from borrowing from Federal Home Loan Banks, including insurance companies with foreign-domiciled parent entities and foreign-owned banks. Even as the FHFA seeks to rebalance the benefits of the FHLB System from private profit to its public purpose, all benefits of the government subsidized system should remain in the United States.

6. We support your recommendation to increase the percentage of System profits that are contributed to the Affordable Housing Program from 10% to at least 20% by seeking Congressional action to amend the statute. We further encourage you to offer rulemaking to cap dividends from the FHLBs to their members at a level equal to their Affordable Housing Program contributions to incentivize FHLBanks to implement a more balanced use of System profits.

7. We encourage FHFA to study the extent to which the System is exposed to added risk posed by McCarran-Ferguson's effect on the "superlien" when it comes to insurance borrowings and implement rules requiring higher interest rates from insurance borrowers to compensate for any such risk.

We believe that Apollo's use of FHLB advances highlights how the FHLB has strayed from their original mission of financing for affordable housing. UFCW applauds FHFA for taking leadership to realign FHLBanks with their public purpose and setting them on course to address housing affordability for American workers.

Sincerely,

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Endnotes

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[1] Congressional Budget Office, "The Role of Federal Home Loan Banks in the Financial System" (Washington D.C.: Congressional Budget Office, March 7, 2024), https://www.cbo.gov/publication/59712

[2] Fair Market Rent is defined as the 40th percentile level and affordability is defined as spending 30% or less of your income on rent. https://www.huduser.gov/portal/datasets/fmr.html , https://nlihc.org/sites/default/files/oor/California_2023_OOR.pdf and https://nlihc.org/oor/about

[3] https://www.bloomberg.com/news/articles/2024-04-19/nearly-half-of-califonia-s-riverside-residents-struggle-to-pay-bills-in-poll?srnd=homepage-americas

[4] See Apollo Global Management "Form 10-K for period ending 12/31/2023", 3/1/2024, p. 108 https://www.sec.gov/ixviewer/ix.html?doc=/Archives/edgar/data/1858681/000185868124000031/apo-20231231.htm

[5] See Apollo Global Management "Form 10-K for period ending 12/31/2023", 3/1/2024, p. 108 https://www.sec.gov/ixviewer/ix.html?doc=/Archives/edgar/data/1858681/000185868124000031/apo-20231231.htm

[6] Johnson, Jennifer, "Capital Markets Bureau Primer" (NAIC, 2020) https://content.naic.org/sites/default/files/capital-markets-primer-federal-home-loan-banks.pdf

[7] CBO, "The Role of Federal Home Loan Banks in the Financial System" (Congressional Budget Office, March 2024), https://www.cbo.gov/publication/60064

[8] Steven Kelly, Susan McLaughlin, and Andrew Metrick "FHLB Dividends: Low-Hanging Fruit for Reconfiguring FHLB Lending" Yale School of Management Program on Financial Stability. January 18, 2024. https://som.yale.edu/story/2024/fhlb-dividends-low-hanging-fruit-reconfiguring-fhlb-lending

[9] FHLBanks Office of Finance 2023 Annual Report, February 2024. https://www.fhlb-of.com/ofweb_userWeb/pageBuilder/fhlbank-financial-data-36

[10] Claire, Abigail, "Loans from Federal Home Loan Banks: An opportunity for US insurers to enhance investment yield and total return" (Wellington Management, June 2022) https://www.wellington.com/en/insights/federal-home-loan-banks-opportunity

[11] Cox, Bruce; Tripathy, Ashish, "Spread Investing Strategies for Insurance Companies: Q2 2019" (FHLBank Chicago, May 2019) https://www.fhlbc.com/solutions/details/spread-investing-strategies-for-insurance-companies-q2-2019

[12] FHFA, March 31, 2024, "FHLB Members Q12024" (FHFA, March 31, 2024) https://www.fhfa.gov/sites/default/files/2024-05/FHLB_Members_Q12024.xlsx

[13] For Q12024 see: Federal Home Loan Banks, "Combined Financial Report for the Quarterly Period Ended March 31, 2024" (Federal Home Loan Banks, March 24, 2024) https://www.fhlb-of.com/ofweb_userWeb/resources/2024Q1CFR.pdf

For 1997 see: Claire, Abigail, "Loans from Federal Home Loan Banks: An opportunity for US insurers to enhance investment yield and total return" (Wellington Management, June 2022) https://www.wellington.com/en/insights/federal-home-loan-banks-opportunity

[14] Fred Economic Data, St. Louis Federal Reserve Bank (June 2024), https://fred.stlouisfed.org/graph/?g=1pRMJ

[15] "Under the original Bank Act, home mortgages having no more than 15 years to maturity and an underlying real estate value of $20,000 or less were eligible." U.S. Federal Housing Finance Agency, "FHLBank System at 100: Focusing on the Future", p. 43 https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/FHLBank-System-at-100-Report.pdf

[16] David A. Price & John Walter, Private Efforts for Affordable Mortgage Lending Before Fannie and Freddie, 102 Federal Reserve Bank of Richmond Economic Quarterly. 321, 330 (2016). https://www.richmondfed.org/publications/research/economic_quarterly/2016/q4/walter

[17] U.S. Federal Housing Finance Agency, "FHLBank System at 100: Focusing on the Future", p. 43 https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/FHLBank-System-at-100-Report.pdf

[18] FHFA, 2023, "FHLBank System at 100: Focusing on the Future" P. 43 (Federal Housing Finance Agency, 2023) https://business.cch.com/BFLD/FHFA-FHLBank-System-At-100-Report-11072023.pdf

[19] Size of RMBS industry in the US was around 10 trillion in 2022: Fuster, Andreas; Lucca, David; Vickery, James, "Mortgage-Backed Securities" (Federal Reserve Bank of New York, February 2022)
https://www.newyorkfed.org/medialibrary/media/research/staff_reports/sr1001.pdf
On private- and agency-MBS held in 2022 by life and P&C insurance industry in US: Wong, Michele, "Growth in U.S. Insurance Industry's Cash and Invested Assets Declines to 1.3% at Year-End 2022" (NAIC 2022)
https://content.naic.org/sites/default/files/capital-markets-special-reports-asset-mix-ye2022.pdf

[20] According to the Annual Statement for the year 2023 of the Athene Annuity and Life Company (FHLB Member) Schedule Y, the corporate structure is as follows:
Athene Annuity and Life Company is 100% owned by Athene Annuity & Life Assurance Company.
Athene Annuity & Life Assurance Company is 100% owned by Athene Annuity Re Ltd, a Bermuda Company.

[21] Apollo Global Management 10-K Report to the Securities and Exchange Commission for the year ending 12/31/2023, p. 22. https://www.sec.gov/Archives/edgar/data/1858681/000185868124000031/apo-20231231.htm

[22] 2023 Financial Statements-Statutory Basis pdf p64-65 provides a list of FHLB funding agreements outstanding, along with other types of funding agreements. PDF p. 65 says this:

As discussed in Note 7, the Company's funding agreements are ceded to AARe under modified coinsurance reinsurance agreements.

[23] "Apollo scores victory over dissident investors," Sujeet Indap and Mark Vandevelde, Financial Times, 8/7/2019. https://www.ft.com/content/aa645edc-b88a-11e9-8a88-aa6628ac896c A Bermuda Court has barred a U.S. lawsuit against a different Bermuda-registered subsidiary of Athene Holding, requiring the case to be filed in Bermuda courts.

[24] FHLBank of Boston 2022 10-K p.44
https://www.sec.gov/Archives/edgar/data/1331463/000133146323000054/fhlbbost-20221231.htm

[25] https://www.govinfo.gov/content/pkg/COMPS-12153/pdf/COMPS-12153.pdf

[26] Ryan Donovan "RE: Comments on Notice of Proposed Rulemaking - Resolution Plans 12 CFR Part 360, RIN 3064-AF90" to Federal Deposit Insurance Corporation. 11/30/2023.
https://www.fdic.gov/resources/regulations/federal-register-publications/2023/2023-resolution-plans-required-idi-100-billion-more-total-assets-3064-af90-c-005.pdf

[27] U.S. Federal Housing Finance Agency, "FHLBank System at 100: Focusing on the Future", p. 44-45
https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/FHLBank-System-at-100-Report.pdf

[28] U.S. Federal Housing Finance Agency, "FHLBank System at 100: Focusing on the Future", p. 31
https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/FHLBank-System-at-100-Report.pdf