

# Bipartisan Senate proposal seeks partial reversal of FHFA captive insurance exclusion

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### **Introduction**

Certain captive insurers that lost or will lose membership in the US Federal Home Loan Bank (FHLB) system as a result of a January 2016 rulemaking by the Federal Housing Finance Agency (FHFA) may get a reprieve under the Housing Opportunity Mortgage Expansion (HOME) Act introduced by Senators Tammy Duckworth (D-IL), Tim Scott (R-SC) and Ron Johnson (R-WI) on January 30 2018.

(1) Representatives Randy Hultgren (R-IL) and Gwen Moore (D-WI) introduced a similar bill in the House of Representatives in June 2017. (2) Significantly, the proposals provide only for the restoration of FHLB membership for captive insurers, not for new membership for those captive insurers that previously had no membership.

### **Background**

The FHLB Act restricts membership in the FHLB system to US-based insured depository institutions, community development financial institutions and insurance companies that make home mortgage loans. (3) For many years, the FHFA and its predecessors interpreted this restriction as effectively authorising membership to any regulated insurer domiciled in the United States, including captive insurers owned by real estate investment trusts and other entities that would not qualify for FHLB membership on their own. (4)

However, beginning in 2010, the FHFA began to reassess participation in the FHLB system by captive insurers that are controlled by ineligible parent companies. (5) Underlying the agency's concern was the fear that ineligible companies were forming captive insurers solely to acquire FHLB system membership in order to access below-market funding through advances from FHLBs. (6) This reassessment culminated in a 2016 rulemaking in which the FHFA defined 'insurance company' to exclude licensed insurers whose primary business is underwriting insurance for affiliates. (7) As a result of this regulatory change, a number of captive insurers lost their FHLB system membership in 2017. (8)

### **Concerns**

Many in the housing finance industry, including the regional FHLBs, have expressed concerns with and opposition to the FHFA's new restriction on insurer participation in the FHLB system. (9) Among other concerns, they have argued that captive insurers are subject to the same regulatory oversight as non-captive insurers and have a similar financial risk profile, meaning that there was no increase in danger to the FHLB system's solvency from captive insurance members. Additionally, FHLBs relied on their captive insurance members as a source of funding for their affordable housing programmes and system operations. By excluding captive insurers, the FHFA reduced both the number of members sharing in the FHLBs' obligations and the financial resources available to the

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FHLBs' housing mission.

## **Proposed congressional action**

As proposed, the HOME Act would allow certain captive insurers to re-join or remain in the FHLB system. To be eligible, the captive insurer would need to have been an FHLB system member before January 19 2016 that was or would be excluded from FHLB system membership solely because of the FHFA's rule change.<sup>(10)</sup>

Additionally, an eligible captive insurer would need to:

- insure an affiliate that makes, owns or acquires long-term residential mortgage loans;
- comply with the FHFA's membership requirements; and
- remain owned by the same controlling entity that controlled the captive on the date of enactment of the HOME Act.

The FHFA would be prohibited from changing its rules to treat covered captive insurers differently from other insurers.

However, the HOME Act would restrict the FHLB system activities of captive insurance members by limiting advances to captive insurers that are not affiliated with a depository financial institution to 50% of the captive insurer's total assets. A captive insurer could avoid this restriction by obtaining a guarantee from an affiliate engaged in the residential housing finance market or a parent that covers the captive insurer's outstanding advances.

As noted recently by the Mortgage Bankers Association, the bipartisan support behind these bills will, if successful, "act as a stabilizing force in the housing finance market and create a reliable source of capital for lenders and investors".<sup>(11)</sup>

## **Takeaways**

It remains to be seen whether this bipartisan bill will overcome legislative inertia. A number of other bipartisan financial reform bills remain in limbo because of ongoing debate on other controversial partisan issues, and there is a limited number of days for Congress to act. The industry will likely push hard to get this small piece of relief across the line during this session in order to avoid disrupting the funding models of a number of non-depository mortgage lenders. However, for those that would like to form a captive insurer for the first time to access FHLB advances, the HOME Act offers no help.

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## **Endnotes**

(1) S 2361, 115th Cong (2018); 81 Fed Reg 3,246 (January 20 2016).

(2) HR 2890, 115th Cong (2017).

(3) 12 USC § 1424(a)(1).

(4) See 81 Fed Reg at 3,254.

(5) 75 Fed Reg 81,145 (proposed December 27 2010).

(6) 81 Fed Reg at 3,254-58. FHLB advances are a low-cost wholesale source of funding for FHLB members because FHLBs fund their operations through the issuance of consolidated obligations that

are exempted government securities that benefit from an implicit federal government guarantee. Additionally, FHLBs and their consolidated obligations are not subject to state or federal income taxes.

(7) 81 Fed Reg at 3,264.

(8) 81 Fed Reg at 3,269; Tim Zawacki, Handful of mREITs left to enjoy 'extreme competitive advantage' of FHLB funding, SNL (March 29 2017).

(9) For example, FHLB Cincinnati, 2015 Annual Report: A Message to Our Members (April 2016).

(10) S 2361 § 2(a)(1).

(11) MBA, MBA Statement on S 2361, the HOME Act (February 1 2018).

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