October 18, 2022

Delivered Electronically

The Honorable Sandra Thompson
Director
Federal Housing Finance Agency
Constitution Center
400 7th Street, SW
Washington, D.C. 20219

Dear Director Thompson:

The American Bankers Association (ABA),[1] the Independent Community Bankers of America (ICBA),[2] and the undersigned state associations are writing to bring to your attention a regulatory inconsistency that, given the current economic environment, requires alignment in a timely fashion to avoid unintended consequences. Although bank capital regulations were updated a decade ago, 12 CFR Section 1266.4, directs the Federal Home Loan Banks (FHLBs) to use tangible capital in assessing a commercial bank's credit worthiness for purposes of issuing advances. In the event that a bank does not meet the required tangible capital levels, it could be denied access to the FHLB advance system unless its Primary Federal Regulator (PFR) requests in writing that an advance be made or rolled over.

We believe that the misalignment could lead to significant administrative bottlenecks between the FHLB and the banking regulators, particularly given today's unique combination of monetary tightening and pandemic-driven composition of bank balance sheets. To ensure that the Federal Housing Finance Agency (FHFA) is using the most up-to-date capital definition, we recommend that the agency modify Section 1266.4 so that it looks to Tier 1 capital, as defined by the FDIC in Part 324.2. This could be done most efficiently through an interim final rule.

Bank capital regulations were updated almost 10 years ago to ensure that bank capital is robust, reflects modern banking and markets, and that, by extension, banks are able to withstand stress. Accordingly, as a general matter, We believe that Tier 1 capital, as defined by the Federal Reserve, FDIC and OCC (the banking agencies) offers the best assessment of a bank's financial condition. As it currently stands, the FHFA and the banking agencies adjust GAAP capital in different ways, resulting in different capital levels for the same institution, which can cause confusion. Consistency of capital definitions across regulations is necessary, then, to avoid unintended consequences arising from the way market and economic events are measured and accounted for under different capital regimes.

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[1] The American Bankers Association is the voice of the nation's $23.7 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard nearly $19.6 trillion in deposits and extend $11.8 trillion in loans.

[2] The Independent Community Bankers of America® is the nation's voice for community banks with its mission to create and promote an environment where community banks flourish. With nearly 50,000 locations nationwide, community banks constitute roughly 99 percent of all banks, employ nearly 700,000 Americans and are the only physical banking presence in one in three U.S. counties. Holding nearly $5.9 trillion in assets, over $4.9 trillion in deposits, and more than $3.5 trillion in loans to consumers, small businesses and the agricultural community, community banks channel local deposits into the Main Streets and neighborhoods they serve, spurring job creation, fostering innovation and fueling their customers' dreams in communities throughout America.

For example, one key difference between FHFA tangible capital and bank regulatory capital is that the bank capital regime allows all but the largest banks the option of excluding unrealized gains and losses on Available For Sale (AFS) debt securities so that market swings do not affect regulatory capital levels.[3] Under the FHFA's calculations, however, unrealized gains and losses on AFS securities "flow through" to tangible capital, creating unnecessary capital volatility. As the bank regulators have recognized, looking to tangible capital could create confusion and, in a rising interest rate environment such as today's, incorrectly suggest that otherwise sound banks are not creditworthy for purposes of access to FHLB advances. This is particularly true for community banks. As the FHFA is aware, throughout the pandemic bank customers sought the safety of bank deposits, some of which banks invested in short-term, high quality liquid securities. Accordingly, the vast majority of securities currently held by banks are U.S. Treasury, GSE or municipal securities – securities that have minimal credit risk. However, the Federal Reserve's move toward a less accommodative monetary policy stance means that markets are adjusting to a new environment, and as such, valuations of even the safest securities are affected.

We and our members understand the importance of robust interest rate and liquidity risk management and continued dialogue between the FHLBs and bank supervisors. The FHLBs also engage in a rigorous credit review process of their membership, and banks are highly regulated and frequently examined, so there are multiple layers of protection in place to protect the FHLBs from losses. These measures are key in assessing whether any unrealized AFS losses may reflect more serious problems that warrant additional actions by the FHLB or bank supervisors.

Making the change from tangible capital to regulatory capital in the near term, prior to any future stress, would help to ensure that banks, particularly smaller banks, have seamless access to an important liquidity tool without compromising the FHLBs' ability to screen for troubled institutions or work with a bank's PFR. Failure to fix this inconsistency in the regulations may exacerbate a stress as banks continue to navigate rising rates and the ongoing macroeconomic volatility. This in turn may impair banks' ability to provide credit to U.S. businesses and households, especially the more vulnerable sections of our economy. We encourage the FHFA to work closely with the banking agencies to better align Section 1266.4, and recommend the FHFA consider adjusting for unrealized gains and losses across its body of regulations.

Thank you for considering this issue. ABA and ICBA, and the undersigned associations appreciate your attention to the matter and stand ready to help. Please do not hesitate to reach out to Alison Touhey, atouhey@aba.com or Chris Cole, chris.cole@icba.org, should you have questions or would like additional information.

Sincerely,

American Bankers Association
Independent Community Bankers of America

Alabama Bankers Association
Alaska Bankers Association
Arizona Bankers Association
Arkansas Bankers Association
Arkansas Community Bankers
BankIn Minnesota
Bluegrass Community Bankers Association
California Bankers Association
California Community Banking Network

[3] 48 Federal Register 55340 (September 10, 2013)

Colorado Bankers Association
Community Bankers Association of Georgia
Community Bankers Association of Illinois
Community Bankers Association of Kansas
Community Bankers Association of Ohio
Community Bankers Association of Oklahoma
Community Bankers of Iowa
Community Bankers of Michigan
Community Bankers of Washington
Community Bankers of West Virginia
Delaware Bankers Association
Florida Bankers Association
Georgia Bankers Association
Hawaii Bankers Association
Idaho Bankers Association
Illinois Bankers Association
Independent Bankers Association of New York State
Independent Bankers Association of Texas
Independent Banks of South Carolina
Independent Community Bankers Association of New Mexico
Independent Community Bankers of Colorado
Independent Community Bankers of South Dakota
Independent Community Banks of North Dakota
Indiana Bankers Association
Iowa Bankers Association
Kansas Bankers Association
Kentucky Bankers Association
Louisiana Bankers Association
Maine Bankers Association
Maryland Bankers Association
Massachusetts Bankers Association
Michigan Bankers Association
Minnesota Bankers Association
Mississippi Bankers Association
Missouri Bankers Association
Missouri Independent Bankers Association
Montana Bankers Association
Montana Independent Bankers
Nebraska Bankers Association
Nebraska Independent Community Bankers
Nevada Bankers Association
New Hampshire Bankers Association
New Jersey Bankers Association
New Mexico Bankers Association
New York Bankers Association
North Carolina Bankers Association
North Dakota Bankers Association
Ohio Bankers League
Oklahoma Bankers Association
Oregon Bankers Association
Pennsylvania Association of Community Bankers

Pennsylvania Bankers Association
Puerto Rico Bankers Association
Rhode Island Bankers Association
South Carolina Bankers Association
South Dakota Bankers Association
Tennessee Bankers Association
Texas Bankers Association
Utah Bankers Association
Vermont Bankers Association
Virginia Association of Community Banks
Virginia Bankers Association
Washington Bankers Association
West Virginia Bankers Association
Wisconsin Bankers Association
Wyoming Bankers Association

c.c. Michael Gibson
Doreen Eberley
Jay Gallagher