Congress of the United States
House of Representatives
Washington, DC 20515–1013

December 1, 2022

The Honorable Sandra Thompson
Director
Federal Housing Finance Agency
400 7th Street SW
Washington, DC 20024

Dear Director Thompson:

We write with great concern, urging you to immediately issue an interim final rule that would modernize Federal Housing Finance Agency (FHFA) regulatory capital standards and align them with those of the Primary Federal Regulators (the PFRs: the Federal Reserve, the Federal Deposit Insurance Corporation, and Office of the Comptroller of the Currency) as issued under the Basel III capital standards.

Current FHFA regulatory capital standards require community banks to recognize unrealized “paper losses” on secure investments in U.S. Treasuries and other investment grade debt caused by changes in interest rates. While these “losses” are unrealized, their recognition, under the outdated FHFA regulatory capital framework, will effectively cut off numerous, sound and prudent community banks from vital Federal Home Loan Bank (FHLB) advances needed to sustain their critical banking operations and liquidity measures. In contrast to FHFA capital rules, the PFR’s modernized capital rules under Basel III permit the exclusion of these unrealized losses when determining regulatory capital levels. We urge you to avert an unnecessary liquidity crunch that would be wholly attributable to outdated FHFA capital rules.

In response to the pandemic, the government provided stimulus to households, businesses, local governments, and non-profits that flooded community banks with new deposits. In the absence of robust lending opportunities, these deposits were typically invested in risk-free U.S. Treasuries and other U.S. government sponsored enterprise debt. As the Federal Reserve has rapidly increased interest rates in an effort to curb inflation, these investments yield less than newly issued Treasuries, resulting in unrealized “mark-to-market” losses based on their current fair value. However, these losses are temporary, reflecting a procyclical and historically disjointed market. As the market normalizes, the fair values of these investments will stabilize and eventually recover their value. Recognition of unrealized mark-to-market losses based on interest rate changes creates a distorted picture of a community bank’s capital position.

The PFRs’ capital rules were modernized in 2015 so that a bank is not required to include unrealized losses on certain investment securities in its calculation of tangible capital. Unfortunately, the FHFA’s rule for the calculation of tangible capital for FHLB borrowers, originally in conformance with PFR rules, has not been updated. As a result, a bank may be considered adequately or well-capitalized by its primary federal regulator while having a negative tangible capital position according to mismatched FHFA regulations.

A Federal Home Loan Bank may not issue new advances to a bank that is not "credit worthy" under FHFA rules, unless the bank's primary regulator has granted a waiver. FHLB advances are a critical source of liquidity for thousands of community banks and will help support their activities in the current economic uncertainty and possibly imminent recession. An abrupt cutoff of advances could adversely impact many community banks and impair credit access for millions of small businesses, consumers, and communities. The FHFA must act immediately to avert an unnecessary economic challenge by conforming its capital rules to those of the PFRs. Doing so would not create more risk for the FHLBs because advances are fully collateralized and protected against any losses. Moreover, a rule change would not prevent the PFRs' ability to resolve a troubled or failing institution if necessary.

We also believe the PFRs have an important role to play alongside the FHFA—particularly for providing the necessary support community banks need today. The PFRs have authority to grant waivers that would allow community banks to continue to access FHLB advances and the critical liquidity they provide. Such waivers for banks that are already well capitalized under existing PFR rules would be consistent, appropriate, and necessary. Therefore, we urge the PFRs to immediately issue the necessary waivers without any further delay.

A solution to this problem will require all parties – the FHFA and the PFRs – to recognize the urgency of this situation and to work together to avert real economic harm. Thank you again for your consideration and we look forward to receiving your response.

Respectfully,

David Scott
Member of Congress

Blaine Luetkemeyer
Member of Congress

French Hill
Member of Congress

Ann McLane Kuster
Member of Congress

Sean Casten
Member of Congress

CC: The Hon. Michael S. Barr, Vice Chair for Supervision, Board of Governors of the Federal Reserve
The Hon. Martin J. Gruenberg, Acting Chairman, Federal Deposit Insurance Corporation
The Hon. Michael J. Hsu, Acting Comptroller, Office of the Comptroller of the Currency