

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)<sup>1</sup> and the Independent Community Bankers of America (ICBA),<sup>2</sup> 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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<sup>1</sup> 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.

<sup>2</sup> 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.<sup>3</sup> 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](mailto:atouhey@aba.com) or Chris Cole, [chris.cole@icba.org](mailto: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

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<sup>3</sup> [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