



Consumer Federation of America

The Federal Home Loan Bank System: A Chronological Review and Discussion of Key Issues

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The Federal Home Loan Bank system has been a core fixture of US support for housing and home finance since its creation in 1932. Originally established as 12 (now 11) regional banks, the system has used its special charter and implicit federal guarantee of its debt to increase and sustain its members' liquidity and ability to lend. While the system's original focus was home finance, Congress over the intervening decades has expanded its mission to include other liquidity objectives. The system's membership also has grown, from institutions primarily serving home finance to a much larger universe of the nation's lending institutions.

The federal government's appropriate role in supporting home finance and financial institutions in general has generated serious debate since the financial crisis began in 2008. The other entities with special charters to support housing finance – Fannie Mae and Freddie Mac – were taken into conservatorship then and remain there today. Congress has considered but not moved forward on any legislation to move them out of conservatorship, though the new Administration and several leading members of Congress have indicated it is a priority they plan to pursue.

In this context of potential far reaching changes in the federal government's support for housing and home finance, CFA commissioned this extensive summary of the Federal Home Loan Banks and their evolving mission and membership. Prepared by George Gaberlavage, Principal at Orleans Street Policy Works, LLC and former Policy Integration Director at AARP, it is meant to provide consumers, elected and appointed officials with a comprehensive review of the system. We hope it will help inform all those involved in considering the future of such support.

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Introduction

Summary of Organization and Activities

Established in 1932, the Federal Home Loan Bank (FHLB) System is a large government sponsored enterprise (GSE) with a mission of assisting its member financial institutions to finance housing and certain types of community development lending. At the end of 2014, total system assets were \$913.7 billion.¹ This compares to total assets of \$3.248 trillion for Fannie Mae and \$1.945 trillion for Freddie Mac, the other major GSEs involved in mortgage finance.² Despite its size and importance, the FHLB System is not nearly as well known as Fannie Mae and Freddie Mac and has been studied only infrequently.³

Structure

The FHLB System consists of 11 regional Federal Home Loan Banks (FHL Bank) and an Office of Finance that assists the FHL Banks in accessing the capital markets.⁴ Each FHL Bank is a distinct legal entity with its own board of directors, management, and employees. In addition, each Bank issues its own financial statements. FHL Banks are cooperatively owned by their member financial institutions located within the specific geographic area that each bank serves. Members are required to maintain at least 10 percent of their asset portfolios in mortgage-related assets or be designated as “community financial institutions.”⁵

Membership

As of the end of 2014, the FHL Banks had 7,359 members. Although originally created to serve the thrift industry, the majority of FHL Bank members are now commercial banks (4,860); followed by credit unions (1,260), thrifts/saving associations (895), insurance companies (304), and non-depository community development financial institutions (30).⁶ Membership is voluntary. Upon joining, members are required to purchase capital stock in the FHL Bank and they receive dividends on their shares of capital stock from earnings of the district bank to which they belong.

Functions

FHL Banks provide low cost funds to member financial institutions in the form of advances (loans) to finance housing and community development activities. Provision of advances is the primary activity of the FHL Banks (62 percent of total system assets at the end of 2014). The banks fund this activity through bonds (called consolidated obligations) which are the joint and several liabilities of all the FHL Banks and are issued through the Office of Finance. The FHL Banks also operate programs that enable member institutions to sell mortgage loans (4.8 percent of total system assets).⁷ The FHLB System is self-supporting, funding its operations through earnings on investments (32 percent of total system assets at the end of 2014).⁸

Affordable Housing and Community Investment Programs

The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) required the FHL Banks to undertake specific housing and community development activities. (Until recently, the FHL Banks were also responsible for paying interest on bonds issued to help fund the resolution of the savings and loan crisis.)⁹ Under the Affordable Housing Program (AHP) each FHL Bank must provide 10 percent of net income through its members for low- and moderate income housing. In 2014, FHL Banks provided over \$293 million for the AHP nationally.¹⁰ Under the Community Investment Program (CIP), the banks lend to members at cost to finance loans for moderate-income households and for commercial and economic development in low- and moderate-income neighborhoods. In 2014, the FHL Banks provided some \$2.3 billion in CIP advances for housing projects and \$45 million for economic development projects.¹¹

Federal Benefits and Implied Guarantee

The Federal Home Loan Bank Act confers on the FHL Banks a number of special privileges and exemptions that result in lower costs and assist them in carrying out their mission including:

- The Secretary of the Treasury may purchase up to \$4 billion of FHLB securities (line of credit for system as a whole);
- Eligibility of their debt for Federal Reserve open market purchases, including unlimited investment by insured commercial banks and thrifts, and collateralizing public deposits;
- Exemption from the bankruptcy code by way of being considered “federal instrumentalities”. FHL Banks have a priority on collateral claims on member institutions, over any and all other creditors (the so-called super lien);
- Federal Reserve Banks may be used as fiscal agents;
- Bank earnings are exempt from federal, state, and local income tax; and
- Interest paid to investors is exempt from state income tax.¹²

Cumulatively, these ties to the federal government generally cause investors in system debt to regard the banks as quasi government agencies and, therefore, they do not require as high a return as they would on debt of a comparable private company. This enables the FHL Banks to borrow at rates close to comparable maturity Treasury issues. Further, while debt issued by the FHL Banks does not carry the full faith and credit of the federal government, financial markets generally assume that the federal government would back these obligations to prevent a default given past experience with a number of similar institutions. This is known as an “implied guarantee”.¹³ While over the years, a number of the FHL Banks have experienced some financial difficulties, the FHL Banks have never had a loss on an advance due largely to strong collateral requirements and the statutory “super lien” which gives FHL Banks priority over the claims of depositors and other creditors.¹⁴

Regulation by the Federal Housing Finance Agency (FHFA)

The provision of government guarantees, whether explicit or implicit, may cause financial institutions to take risks they might otherwise avoid if the guarantee was not present. This increases the chances of financial problems. Because of this potential risk (or “moral hazard”), Congress designated the Federal Housing Finance Agency (FHFA) to regulate the FHLB system for “safety and soundness.” This agency also regulates Fannie Mae and Freddy Mac.¹⁵ Effective regulation is also necessary because the system is highly leveraged. At the end of 2014, the average capital to assets ratio for the FHL Bank system was 5.4 percent, roughly half that required for commercial banking institutions.¹⁶

History

Purpose of the Paper

Debate over housing finance reform has largely focused on the two largest GSEs, Fannie Mae and Freddie Mac, overlooking the FHLB system despite its significant size, complexity, and attendant risks.¹⁷ In addition, the FHLB system has undergone significant changes in its structure, membership, and activities since it was established in 1932. The purpose of this paper is to provide a review of the history of the FHLB System discussing how various statutory and regulatory changes over the years have impacted the mission, purpose, and operations of the FHL Banks. In addition, the paper will also discuss a number of key issues for the future of the System and its role in the nation's housing finance system. These include growth and efficacy of the system, the role of larger member institutions, mitigating potential risks associated with the structure and operation of the system, and improvements to the AHP and CIP programs. It starts from the assumption that the federal government has an affirmative and important role to play in shaping and supporting a national housing policy.¹⁸

Origins and Early Years of the System – 1932 to 1960

Policy Entrepreneurship of President Hoover

FHLB System was a response to the Great Depression and resulted from the policy entrepreneurship of President Herbert Hoover. In his 1931 State of the Union, he asked for legislation to create a system of “home loan discount banks.” The purpose was to reduce financial stresses caused by the Depression on building and loans, banks and other financial institutions that were providing credit for consumers to purchase homes, aid in the revival of construction and employment, protect against a future financial crisis, and strengthen financial institutions like building and loans associations that were promoting home ownership. The previous year, he had convened a White House Conference on Home Building and Home Ownership.¹⁹

Promoting Homeownership as National Policy

Hoover had been working to make the promotion of homeownership a national policy issue since he became Secretary of Commerce (1921-1928) and started a Division of Building and Housing. Conference and Commerce Department experts determined that the structure of housing finance was the main barrier to maintaining and providing wider access to homeownership.²⁰

Short-term vs. Long-term Mortgages

At the time, home purchases were financed with first mortgages for 40-60 percent of home value with terms of 1-5 years (called “straight mortgages”) and then the consumer had to refinance. The Depression made the disadvantages of this system worse and the rate of foreclosures increased rapidly from 1929-1931. Hoover wanted to strengthen the position of building and loans (more commonly known today as savings and loans or thrifts) that offered longer term amortized loans with high loan to value ratio. However, as a result of the Depression deposits were being withdrawn by consumers and building and loans were unable to access funds to finance more loans.²¹ They had previously asked Congress for a discount bank but were turned down.²²

Opposition to the Proposed Home Loan Banks

The Hoover Administration floated an initial outline of its proposal by key financial leaders and institutions as well as leaders in Congress. But only the building and loans, realtors, and building materials suppliers were supportive.²³ Many financial industry leaders said the short-term mortgages predominant then were financially sound and once the cycle of foreclosures was completed, the existing system would provide adequate finance. In effect, foreclosures and declining home values were not viewed as problems and there was no need for

home loan banks.²⁴ The initial proposal was based on a more expansive model that would have funded mortgages made by all types of financial institutions including commercial banks. This proposal was revised to primarily help building and loan associations with savings banks and insurance companies also eligible to join the proposed home loan bank system.²⁵

The Federal Home Loan Bank Act of 1932

The Federal Home Loan Bank Act of 1932 was modeled on the Federal Reserve Act and provided for twelve regional banks with districts based on state lines. (Each bank would have its own board of eleven directors, nine of whom would be officers or directors of member institutions and two would be appointed by the Federal Home Loan Bank Board.²⁶) The legislation made each bank a cooperative with member institutions required to purchase stock to access bank services. Eligibility to join was extended to building and loan associations, savings banks, and insurance companies in their districts if they made long-term home mortgage loans. Membership was voluntary with the main incentive being access to loans termed “advances”. Collateral requirements were used to direct the lending of member institutions toward public purposes. The legislation outlined features of eligible mortgages, and focused on long-term full amortization loans. A \$20 thousand limit was placed on the value of mortgaged properties and only mortgages for owner occupied homes could be offered as collateral.²⁷ In addition, the legislation created a five member Federal Home Loan Bank Board to regulate the FHL Banks. Members were to be appointed by the President with Senate confirmation.²⁸

Funding for Advances

Funding for advances would come from the capital of FHL Banks and issuing debt securities (bonds). At first, each FHL Bank issued its own bonds but this proved inefficient and because of the joint liability required under the FHL Bank Act, the System started issuing them centrally (through the Office of Finance). These bonds became known as consolidated obligations.²⁹ In addition to providing collateral for an advance, members are required to purchase additional stock as a percentage of the size of the institution’s advance.³⁰ The ability to issue debt securities assured adequate resources were available to effectively address the problem the creation of the System was intended to solve. Further, the creation of regional banks addressed the need for funds from a geographic basis. The FHLB Act provided that the FHL Banks could lend to each other and hold bonds and deposits in other Home Loan banks to operate for the long term as a national system.³¹

Passage of the FHLB Act and Attempted Repeal

In July, 1932, the FHLB Act became law with bipartisan support.³² However, eight months later a controversy erupted over a provision requiring the FHL Banks, as a last resort, to make direct loans to consumers to refinance mortgages if no other lender could be found. (This provision applied only as long as the federal government held stock in an FHL Bank. In the start-up phase of the FHLB system, the federal government provided start-up capital but this stock was eventually bought out by the FHL Banks.). However, the attempt to repeal faded out after President Roosevelt asked Congress for legislation to deal with the foreclosure problem which eventually became the Homeowners Loan Act (HOLA) in 1933.³³

HOLA and the National Housing Act of 1934 – Expansion of the System through Federally Chartered Thrifts & Deposit Insurance

HOLA established the Home Owners’ Loan Corporation (HOLC) to refinance the loans of homeowners at risk of foreclosure (this agency was liquidated in 1951) but at the same time, it incorporated a proposal by the Federal Home Loan Bank Board to federally charter savings and loans as a way of filling a gap in local institutions. As it was establishing the FHLB system, the Board had found that one-third of the counties in the U.S. did not have any financial institutions providing home mortgages. HOLA gave the Federal Home Loan Bank Board authority to charter and regulate federal savings and loans which were required to become members of their FHL Banks. The FHL Banks were made agents of the Board in its role as safety and soundness regulator of the new federal savings and loans.³⁴ Under the National Housing Act of 1934, the authority of the Board was further expanded when it became the administrator of the Federal Savings and

Loan Insurance Corporation (FSLIC) which provided deposit insurance for savings and loan institutions.³⁵ The FHL Banks started issuing debt in 1937. They helped their member institutions get safely through the depression and played an important role in addressing the postwar housing shortage.³⁶

Interest Rate Escalation, the Credit Crunch, and Onset of the Savings & Loan Crisis – 1960s through the 1980s

Advances Grow

The FHLB System grew slowly from the 1930s through the 1950s. FHLB advances were less than 3 percent of assets in 1960. But this changed in later half of 1960's with volatile interest rates and tight money. FHLB advances increasingly became an alternate source of low-cost liquidity for thrifts, given the limits on interest rates under federal rules (Regulation Q) that they could pay depositors.³⁷

Interest Rate Control Act of 1966

Under the Interest Rate Control Act of 1966, Congress amended the Federal Home Loan Bank Act to allow the Federal Home Loan Bank Board to regulate the rates that savings and loans could pay on deposits. Savings and loans were able to pay higher rates on small deposits than commercial banks in order to attract funds. This temporary stop-gap measure allowed mortgage lending to start again.³⁸

The Federal Home Loan Mortgage Corporation Act of 1970 – Creating a Secondary Market for Home Mortgages Originated by FHL Bank Members

Interest rates started increasing again in 1969 with a resulting money crunch and shortage of mortgage credit. A number of proposals were made in Congress to provide new money for FHL Banks to subsidize additional advances. The Chair of Federal Home Loan Bank Board argued this would not be adequate to solve the problem and recommended, in addition to new subsidies for advances, that a secondary market for mortgages originated by savings and loans and other FHL Bank members, should be created that would tap pension funds and other institutional sources that advances did not. This led Congress to pass the Federal Home Loan Mortgage Corporation Act of 1970 which established the Federal Home Loan Mortgage Corporation (Freddie Mac) and authorized it to issue mortgage backed securities (MBS). Under the Act, Freddie Mac was owned by the Federal Home Loan Banks with the Federal Home Loan Bank Board serving as its Board of Directors. This expanded FHLB System's means for supporting its housing finance mission and Freddie Mac was part of the FHLB System for almost 20 years.³⁹

The Savings and Loan Crisis

Interest rate volatility throughout the 1970's and 1980's (as high as 21.5 percent in 1980) made it difficult for savings and loans to rely on deposits as the source of funds for making home loans. Short-term rates rose above levels they could pay on deposits given yields on the mortgages they held and many depositors moved their savings to alternatives like money market funds. This disparity in interest rates was a key cause of the savings and loan crisis. The majority of thrift industry losses through 1982 and about half of the public cost to resolve the crisis were attributable to this problem.⁴⁰

The Depository Institutions Deregulation and Monetary Control Act (DIDMCA) of 1980 and the Garn-St. Germain Depository Institutions Act of 1982

In the early 1980s, Congress reacted to the problems savings and loans were experiencing by lifting interest rate limitations and removing restrictions on the types of assets they could hold. DIDMCA gradually lifted interest rate ceilings on time and savings deposits to allow savings and loans to compete by offering more interest. To help pay the additional interest being offered on deposits, Garn-St. Germain allowed savings and loans to try to boost earnings by moving beyond traditional investments in home mortgages into assets with

which they often had little or no experience.⁴¹ It allowed the Federal Home Loan Bank Board to expand the definition of eligible collateral enabling FHL Banks to accept as collateral “any” property they deemed acceptable and in which an interest could be secured.⁴² Failed investments in these kinds of assets made up about a quarter of resolution costs. The remaining 25 percent is attributable to all other factors including fraud.⁴³

Growth of the FHLB System

From the late 1960s through the early 1980’s, the FHLB system grew substantially in terms of assets. Between 1980 and 1985, total assets more than doubled from \$54 billion to \$112 billion while membership decreased by 20 percent. This reflects the fact that advances became an important tool for improving member balance sheets given the disparities in the maturities of their mortgage assets and deposit liabilities resulting from interest rate escalations.⁴⁴

Change in Regulatory Structure & Conflict of Interest – Transfer of FHLB Bank Board Examination Staff to the FHL Banks

In July 1985, the Federal Home Loan Bank Board transferred its examiners to the FHL Banks. This allowed the number of examiners to be increased to deal with the growing savings and loan crisis while avoiding federal salary and staffing limits.⁴⁵ However, having the FHL Banks supervise thrifts for the Board created major conflicts of interest such as FHL Banks regulating institutions to which they were making advances. This was seen by Congress as compromising the effectiveness of safety and soundness regulation of the thrift industry.⁴⁶

Congress Reacts to the Savings & Loan Crisis – The Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA), 1989

The Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA)

In 1989, Congress passed FIRREA to resolve the savings and loan crisis. The Federal Savings and Loan Insurance Corporation administered by the Federal Home Loan Bank Board did not have adequate funds to resolve all the failing savings and loans. FIRREA recapitalized the savings and loan industry deposit insurance fund and provided public funds to make whole depositors in failing institutions. At the time, the cost was estimated at between \$100 and \$500 billion. (The actual cost was approximately \$153 billion.)⁴⁷

FIRREA made major changes in the FHLB System’s regulation, membership, and mission requirements. These included:

- **Capitalize the Resolution Funding Corporation (REFCORP)** – FIRREA required the FHLB System to capitalize REFCORP to help pay for the deposit insurance fund losses resulting from thrift failures. In order to minimize budget outlays, the principle on \$30 billion in 40 year REFCORP bonds was underwritten (or “defeased”) using \$2.8 billion of the System’s net worth.⁴⁸ In addition, the System was assessed up to \$300 million per year of annual earnings to contribute towards interest payments on bonds issued by the REFCORP to pay for thrift losses.
- **New Regulator** – FIRREA abolished the FHL Banks’ regulator, the Federal Home Loan Bank Board and established the Federal Housing Finance Board (FHFB) to regulate the 12 FHL Banks. It also transferred the Bank Board’s supervisory and regulatory responsibilities for thrift institutions and their holding companies to a new agency, the Office of Thrift Supervision. Further, the FSLIC, the deposit insurance fund administered by the Board since 1934 was replaced by the Savings Association Insurance Fund (SAIF) in the Federal Deposit Insurance Corporation.
- **Open Membership to Commercial Banks & Credit Unions** – FIRREA allowed commercial banks and credit unions that financed mortgages to become members of FHL Banks. These

voluntary members were required to invest capital in their FHL Bank but could withdraw that capital on 6 months' notice. FIRREA continued the requirement that thrifts be members of their respective FHL Bank and did not allow them to withdraw their capital contributions.

- **Establish Community Investment and Affordable Housing Programs** – FIRREA required each FHL Bank to establish two low- and moderate income housing programs – the Community Investment Program (CIP) and the Affordable Housing Program (AHP). Under CIP, advances are provided by each FHL Bank to member institutions to finance community projects benefiting residents of low- and moderate-income neighborhoods and the purchase or rehabilitation of housing for eligible households. AHP requires each FHL Bank to subsidize the financing of eligible low- and moderate-income housing with specific priorities for eligible project set under the Act.⁴⁹

Reason for Membership Changes

Opening membership in the FHLB system to commercial banks was not actively sought by bankers and they were not major advocates of this change. During consideration of the Federal Home Loan Bank Act of 1932, the commercial banks had opposed being included. In fact, commercial banks were hesitant to join FHL Banks after membership was opened because they saw them as regulators and part of a failed thrift industry.⁵⁰

In addition to helping pay for the REFCORP assessment, a major impetus for allowing commercial banks to become members of FHL Banks was the desire of supporters of the Affordable Housing Program, like House Banking Committee Chairman Henry Gonzalez, to assure that there would be adequate resources for the program. While each FHL Bank would be assessed 10 percent of earnings to support the program in return they would be able to recruit commercial banks to increase those earnings. Also, by allowing commercial banks to join the FHLB system, it would encourage these institutions to make mortgage loans with features that were helpful to consumers. Further, to emphasize the use of system advances to facilitate lending for housing, the FHL Banks' public purpose was stated for the first time in the House Conference Report on FIRREA (“to promote economical housing finance by serving as lending facilities for their member institutions”).⁵¹

Tying Advances More Closely to the FHLB System's Housing Mission

The House Majority Report questioned whether the cash advance program was “truly living up to its primary role” and noted a GAO study that concluded that savings and loans receiving advances did not show greater commitment to mortgage lending than those that did not.⁵² FIRREA attempted to address this concern by requiring the Federal Housing Finance Board to adopt regulations establishing minimum community lending standards to be met by institutions seeking to borrow from the general cash advance window.⁵³ For the first time, it also restricted the use of long-term advances to “residential housing” and tightened eligible collateral requirements (whole first mortgages, US securities, including residential mortgage-backed securities; deposits in FHL Banks and limited amount of other real estate related collateral.) As noted previously, Garn-St. Germain had allowed the loosening of rules regarding collateral.

To further the use of advances to support housing finance, FIRREA required a commercial bank to have at least 10 percent of its assets in commercial mortgage assets (the 10 percent test). In addition, a bank's ability to obtain advances was restricted if it did not have a minimum of 65 percent of its assets in mortgage loans and other housing related investments (the qualified thrift lender or QTL restriction) and non-QTL members were required to purchase more stock than ordinary members to obtain advances. Advances to non-QTL members were limited to no more than 30 percent of any FHL Bank's total advances.⁵⁴

Refocusing the Housing Mission – The Affordable Housing Program

The provisions of FIRREA that established the Affordable Housing and Community Investment programs originated in the House of Representatives. This was part of a significant effort by housing advocates in the House of Representatives, to use FIRREA as a means to:

“Reestablish, reinforce and target the Federal home loan banks’ statutory purpose as supporters of the mortgage market, the Committee adopted an amendment to provide a new structure for the advance mechanism or “windows” and *a new focus on today’s housing credit needs* (italics added).”⁵⁵

Members supporting the House language establishing the Affordable Housing Program were concerned about the crisis in the availability of housing to serve low-income households and reductions in the funding of HUD housing programs serving low-income households made in preceding years. They saw FIRREA as a way for making up some of this lost funding as well as a matter of equity given the large public expenditures needed to resolve failed savings and loans.⁵⁶

An Attempt to Strike the Provision Establishing the Affordable Housing and Community Investment Programs Fails

Opposition to the Affordable Housing and Community Investment Programs was significant. The Chairman of the Federal Home Loan Bank Board opposed the affordable housing and community development mandates as did six FHL Bank Presidents who cited them as “another misguided provision” and “a hidden subsidy for low-income housing provided by thrift institutions that are already faced with the prospect of higher deposit insurance premiums... and reduced earnings.”⁵⁷ This opposition was consistent with prior behavior of many of the FHL Banks which were heavily involved in home mortgage redlining through use of “residential security maps” and by preventing new savings and loans from being established in inner city neighborhoods.⁵⁸

However, the industry and the Federal Home Loan Bank Board were discredited and weakened politically. Lobbying of consumer groups including ACORN and CFA as well as the National Association of Realtors was significant but the support of House Banking Chairman Gonzalez was pivotal in assuring that the affordable housing provisions remained in the bill.⁵⁹ A House floor amendment sponsored by Rep. Steve Bartlett to strike the provisions was defeated by only two votes (206 to 208).⁶⁰ The provisions were retained in the final legislation.

Affordable Housing Program Funding and Priorities

FIRREA requires every FHL Bank to establish an affordable housing program (AHP) to finance home ownership and rental housing for low-and moderate income families. Initially, contributions were set at 5 percent of the bank’s previous year’s net income or its prorated share of a system wide total of \$50 million, whichever was greater. They would gradually increase until 1995, when they would be fixed at 10 percent of last year’s earnings or a share of \$100 million system wide.

FIRREA gives priority to housing sponsored by non-profit organizations or state and local agencies, purchase or rehabilitation of housing owned by the U.S. Government, and purchase, rehabilitation or construction of homes including multifamily rental housing by families with incomes at or below 80 percent of area median.⁶¹ Eligibility for multifamily rental housing includes a requirement that at least 40 percent of the units of such a project must be occupied by low or moderate income families for not less than 30 years.⁶² Projects are required to be sponsored by nonprofits or public agencies. Financing is provided through a member institution, typically as a grant.⁶³

The Community Investment Program

FIRREA also requires each FHL Bank to establish a community investment program (CIP) to encourage “community-oriented lending” in “declining neighborhoods.”⁶⁴ Neighborhoods in which 51 percent or more of households have incomes at or below 73 percent of area median may be assisted under the program. Types of projects that are eligible for assistance include home purchases and/or rehabilitation or purchase of rental units for households with incomes at or below 115 percent of area median, and economic development projects that benefit low- and moderate- income households or are located in low- and moderate-income neighborhoods. Savings from at cost advances are provided through reduced interest rates, extended loan

terms or project equity to government, nonprofit or for-profit developers. There is no minimum funding level for bank CIPs.⁶⁵

Structural Changes to Support the Affordable Housing and Community Investment Mission

FIRREA included a number of structural and governance changes to the FHLB System designed to support and encourage the new affordable housing and community investment mission. These include:

- **Federal Housing Finance Board Members** – FIRREA eliminated the Federal Home Loan Bank Board, and created a new Federal Housing Finance Board (FHFB) to replace it and regulate the FHL Banks for safety and soundness. FHFB had a five member board, four of whom were appointed by the President. All were required to have housing finance expertise and at least one was required to have experience representing consumer or community financial services or housing organizations. The Secretary of Housing and Urban Development (HUD) was the fifth member of the Board.⁶⁶
- **FHL Bank Directors** – FIRREA also made changes to the boards of the FHL Banks. It increased the number of appointed public interest directors from two to six (out of 11 total) and required that two of the six have experience representing community or consumer housing or financial services organizations. (Previously, the majority of board members were from member institutions.)⁶⁷
- **Advisory Councils** – FIRREA requires each FHL Bank to create a Housing Advisory Council composed of 7 to 15 persons drawn from community and nonprofit organizations “actively involved in providing or promoting low- and moderate-income housing in its district.”⁶⁸ The Councils’ role is to advise the bank on housing needs in the district and make recommendations about how funds should be used, and submit an analysis assessing their own Bank’s affordable housing activities which would be included in an annual report to Congress.⁶⁹
- **Community Investment Officers** – FIRREA requires each FHL Bank to designate a Community Investment Officer who would have operational responsibility for the Affordable Housing and Community Investment windows and develop an outreach program to promote the use of the special purpose windows. This person would be a senior official reporting directly to the President of the FHL Bank.⁷⁰

FIRREA Promoted a Broader Housing and Community Investment Mission

The Act’s purpose “to promote a safe and stable system of affordable housing finance” and language in the House Conference report concerning the principal function of the FHL Banks “to promote economical housing finance” furthered the new mission by emphasizing housing finance as opposed to just homeownership.⁷¹ Further, the FIRREA debate reemphasized that the FHL Banks were federal instrumentalities organized to carry out public policy and not solely the property of investors.⁷²

The 1990’s – Recovery, Growth, and the Gramm-Leach-Bliley Act of 1999 (GLBA)

The System Focuses on Earnings and Growth

The changes enacted under FIRREA, particularly the REFCORP assessment and the opening of membership to commercial banks, increased the attention of the FHLB System to earnings and growth.⁷³ From 1989 to 1991, the system was contracting, in terms of both membership and assets due to loss of savings and loans. By 1990, membership had fallen to an estimated 3,000 members from 4,244 in 1980.⁷⁴ This put additional pressure on earnings. In order to recoup, FHL Bank managers focused on recruiting commercial banks. FHL Banks started developing and marketing new products including different advance products for different sized banks.⁷⁵

Commercial Banks Become a Majority of FHLB System Members

As noted previously, commercial banks initially viewed the FHL Banks as part of the declining savings and loan industry and as a regulator. But they quickly recognized the value of advances and promoted the FHLB system within state banking associations. Commercial banks became the majority of system members by 1993 and by the end of 2001, 73 percent of the system's members (nearly eight thousand in total) were commercial banks.⁷⁶ However, member thrifts still accounted for a significant share of system capital and advances due to their emphasis on mortgage lending.⁷⁷

Growth of the System Accelerates

By 1992, System assets started growing again.⁷⁸ Asset growth was moderate through mid-decade and then accelerated rapidly so that by 1999, they had increased to \$583 billion, a 376 percent increase over the 1991 low point of \$155 billion.⁷⁹ The amount of advances to members increased 395 percent from \$78.7 billion to \$390 billion and by 1999, the number of members more than doubled.⁸⁰

System Size Exceeds Fannie & Freddie and Becomes World's Largest Issuer of Debt

By 1999, the FHLB System was larger than either Fannie Mae or Freddie Mac and all other U.S. banking organizations with the exception of Citigroup and Bank of America. In 1998, it had become the world's largest issuer of debt, surpassing the U.S. Treasury.⁸¹

Beyond Advances: New Lines of Business with the Potential for Increased Systemic Risk

The effort to increase earnings and provide new services led the FHL Banks to engage in new lines of business that potentially had higher levels of risk than their traditional business of providing advances. These included:

- **Mix of System Asset Types Changes Toward Investments** – In 1990, advances represented 70 percent of all FHLB system assets but between 1991 and 1996 they declined to less than 50 percent. At the same time, system investments, such as holdings of mortgage backed securities (MBS) issued by Fannie Mae and Freddie Mac, increased from 27 percent of assets to 43 percent. In 1991, FHFB made it easier for the FHL Banks to invest in MBS by raising percentage of MBS they could hold as a percentage of their capital (MBS to capital ratio) from 50 to 200 percent. The Board raised the ratio again in 1993 to 300 percent. However, after 1995, investments began declining as a percentage of system assets while advances increased. This was mainly the result of an increasing number of commercial banks joining the system and obtaining advances.⁸²
- **Use of Arbitrage to Boost Earnings Provokes Criticism in Congress** – While still attempting to recruit new members and generate additional advance business, FHL Banks used arbitrage to earn most of their investment income.⁸³ Issuing consolidated obligations at low interest rates, they invested in MBS from Freddie Mac and Fannie Mae and in federal funds. These actions were criticized by Jim Leach, then Chairman of the House Banking Committee, as “Kafkaesque circularity” of “one government-sponsored enterprise using its agency status to purchase another’s products.”⁸⁴ These investments in MBS introduced new and more difficult to manage risks into the FHLB System.⁸⁵
- **FHL Bank Mortgage Purchase Programs** – In 1997, the FHFB authorized the FHL Banks to begin purchasing mortgages from member institutions through mortgage purchase programs. That year, the FHL Bank of Chicago started a pilot Mortgage Partnership Finance Program (MPF). In 1998, FHFB authorized all 12 FHL Banks to create similar mortgage purchase programs. By 2005, 9 FHL Banks offered MPF in conjunction with the Chicago FHL Bank and the 3 remaining banks offered their own mortgage purchase programs (MPP).⁸⁶

Intended as an alternative secondary market, particularly for smaller member institutions, the programs were developed to allow members to earn more on the mortgages they originated than by selling them to Fannie Mae and Freddie Mac. In addition, the programs were seen as a way to allow members to keep their expertise in assessing local credit risk and providing an incentive for commercial banks to expand their mortgage lending.⁸⁷ However, the increased purchases of mortgages through these programs significantly increased the FHL Banks' burden of managing the interest rate risks associated with holding mortgage assets.⁸⁸ These mortgage assets grew to almost 14 percent of all system assets (about \$113 billion) by 2003.⁸⁹

Congress did not necessarily intend or anticipate the dramatic growth of the FHLB System in the 1990's. However, as FHL Banks used their expertise to significantly increase earnings by means of investments and developed new programs and services such as MPP, they came under increased scrutiny and criticism.⁹⁰

Implementing the Affordable Housing Program (AHP)

HUD under Secretary Kemp played a key role in developing the AHP program. A competitive process incorporating a 100 point scoring system across nine criteria (nonprofit sponsorship, subsidy per unit, donated property, targeting, community stability, empowerment, homelessness, first district priorities (developed by bank's housing advisory committee), and second district priorities) was developed to allocate AHP funding.⁹¹

FIRREA governance changes added new perspectives and values into the system. Through the new housing advisory committees, access by community representatives to policy making at the FHL Banks was institutionalized.⁹² Under the Clinton Administration, the appointment of directors with community development, affordable housing and economic development backgrounds was a deliberate tactic to change the FHLB system.⁹³ Between 1990 and 1992, some \$192 million in funding was provided to develop some 53,000 units. In addition, CIP supported some 78,000 units through \$2.7 billion in advances.⁹⁴

Supporting the Viability of Community & Rural Banks

Congress's decision under FIRREA to open the system to commercial banks forced FHL Bank managers to direct attention to bank needs. In some districts, serving the needs of smaller banks became a focus. FHL Banks introduced mortgage matched advances to encourage mortgage lending by community banks where saving and loans were disappearing. Small bond issues are more expensive than large ones so FHL Banks put together offerings for a number of smaller institutions. They also maintained excess liquidity to serve needs of smaller banks and offered advances at same rate to banks of all sizes so that larger borrowers helped subsidize the smaller ones.⁹⁵ Decentralized administration in the FHLB system enabled FHL Banks to address local and regional problems in rural parts of the country.⁹⁶

Impact of the Ten Percent Test and Qualified Thrift Lender Provision of FIRREA on Community & Rural Banks

The 10 percent test limited small rural banks' access to FHLB advances because unlike institutions operating in urban areas they were unlikely to have 10 percent of their assets in housing. Also, the Qualified Thrift Lender (QTL) provision limited how much they could borrow.⁹⁷ Sen. Chuck Hagel of Nebraska played a key role in highlighting these issues and he introduced legislation that subsequently was incorporated into GLBA.⁹⁸

The Housing and Community Development Act (HDCA) of 1992

Although FIRREA strengthened the FHLB System, there were also concerns raised in the 1990s about the stability of its capital structure and its ability to meet all of the goals set forth in the Act. The HDCA required the U.S. Government Accountability Office, the Congressional Budget Office (CBO) and other groups to assess these issues as well as answer a series of questions concerning various aspects of the FHLB System.⁹⁹ Subjects included whether the system could pay its assessments for the saving and loan cleanup and

affordable housing while carrying out its mission, appropriate capital standards for the FHLB System, terms of membership in the System, the role of the FHL Bank system in affordable housing and whether consolidation would affect it, and whether the System should be allowed to offer new products and services. The GAO also addressed issues of corporate governance and regulation of the System. Key findings of the GAO's report included the following:

- **Change Assessments from Fixed Payment to a Percentage of System Income** – GAO found that the System was able to pay the assessment but changing from a system of fixed payments to one based on a percentage of the System income would put less pressure on the system, particularly in times of low earnings, and reduce the need to seek new sources of income.¹⁰⁰ Also, the formula for allocating the payment among the banks created a perverse incentive that could discourage banks from making advances if there was a shortfall because the shortfall was allocated to each district bank in proportion to the share of advances it made. However, such a penalty would not apply if the bank invested in MBS.¹⁰¹
- **Adopt Risk Based Capital and Leverage Requirements** – Because the System's capital stock was redeemable (by voluntary members) and not directly related to risk undertaken by the System, it was not considered a strong protection against risk. Further, the stock was largely financed through federally insured deposits meaning that little of the capital could absorb losses without increasing the exposure of federal insurance deposit funds to risk and the system's retained earnings had dropped significantly since 1989. At the end of 1992, retained earnings fell to \$429 million (0.3 percent of total assets) from \$820 million in 1989.¹⁰² An improved set of capital rules would require permanent capital in the form of minimum required retained earnings.¹⁰³
- **Voluntary Membership for All Members** – Fixed obligations and the ability of voluntary members to redeem their capital stock created potential conflicts between two member classes and created additional risk to the system.¹⁰⁴
- **The System Supports Affordable Housing** – the study found that the FHLB System supported affordable housing through both advances and its targeted programs (AHP and CIP) and consolidation would be unlikely to compromise the programs.¹⁰⁵ The CBO's report also suggested giving membership to non-profits involved in affordable housing and community development.¹⁰⁶
- **Criteria to Evaluate Proposals for New Services** – GAO recommended six criteria to evaluate such proposals including: “1) avoiding competition between FHL Banks and their members, 2) expertise in the new business, 3) consistency with the System's mission, 4) value added by new services, 5) proper pricing of new services, and 6) appropriate risk-taking for the System.”¹⁰⁷
- **Single Independent Regulator for All GSEs** – GAO recommended giving safety and soundness responsibilities for the FHLB System to the Office of Federal Housing Enterprise Oversight (OFHEO) which was then newly created by the HCDA. The report indicated that FHFEB was not “arm's length” from the System it was charged with regulating.¹⁰⁸

The recommendations in this report were the basis for a number of changes incorporated into the Gramm-Leach-Bliley Act of 1999 which was a response to major consolidation and globalization occurring in the financial services industry.

The Gramm-Leach-Bliley Act of 1999 (GLBA)

The capital structure of the FHL Bank System and the system for allocating the financial obligations required by FIRREA raised concerns about the stability of the System. The potential for voluntary members to remove capital from the system with short notice created uncertainty and increased financial risks. Further, weak earnings of the FHL Banks due to declining profitability of the thrift industry made it more difficult for the System to meet the \$300 million REFCORP payment. As noted previously, the FHL Banks turning to new sources of revenue such as MBS offered higher returns but introduced increased risks into the system.

In an attempt to resolve these issues, Congress passed GLBA which contained the following provisions:

- **Voluntary Membership** – GLBA made membership voluntary for all member institutions and eliminated the requirement that membership in the FHL Bank System was mandatory for thrifts.¹⁰⁹
- **Capital Requirements** – GLBA established new capital requirements for FHL Bank members with the goal of making the System’s capital more permanent. FHL Banks may issue class A stock, redeemable with 6 months’ notice and class B stock, redeemable with 5 years notice. GLBA does not allow an FHL Bank to redeem or repurchase capital if the FHL Bank does not meet any minimum capital requirement following redemption.¹¹⁰
- **Leverage Requirements** – GLBA also established leverage requirements. Each FHL Bank is required to meet two minimum capital ratios: 1) permanent capital (equal to amounts paid in for class B stock plus retained earnings) plus class A stock is to be 4 percent of assets and 2) class A stock plus 1.5 times permanent capital is to be at least 5 percent of assets. Each FHL Bank must develop and provide a capital plan to FHFBS for review and approval.¹¹¹
- **Changed from Fixed to Percentage REFCORP Payment** – GLBA changed the System’s REFCORP payment, from a fixed annual payment of about \$300 million to 20 percent of the System’s annual earnings after AHP expenses (10 percent). This change minimized the burden on the System during periods of relatively low profitability but increased the total payment when earnings increased.¹¹²
- **Community Financial Institutions (CFI)** – Under GLBA, a community financial institution was defined as an FDIC insured depository institution with total assets under \$500 million. They were exempted from the 10 percent test so a small rural bank could join a FHL Bank regardless of the size of its housing assets. GLBA also eliminated the QTL test. In addition, it lessened for CFIs provisions of FIRREA that required long-term advances be used for residential housing and permitted them to obtain advances for small business, small farm, and small agribusiness as well as for housing loans. Such loans could also be pledged as collateral.¹¹³ Small banks did not support banking modernization (GLB) but limited the intensity of their opposition with inclusion of the FHL Bank title.¹¹⁴

A New Century & the Financial Crisis, 2000 to 2009

Growth of the System Continues to Accelerate, Assets Reach & Surpass \$1 Trillion

The assets of the FHLB System grew an average of 8.8 percent a year from 2001 to 2005. Strong demand for advances propelled this asset growth. Advances increased at a rate of 7.3 percent between 2001 and 2005 and by the end of this period made up 62.2 percent of total assets.¹¹⁵ Lending (advances) by the System increased significantly as the financial crisis hit with full force. Advances grew from \$641 billion at the end of 2006 to \$875 billion at the end of 2007, an increase of almost 38 percent. As balance sheets expanded in 2007 and 2008, this affected the system’s capital ratio which fell from 4.4 percent in 2006 to 3.8 percent at the end of 2008. However, the ratio rose again to 4.2 percent in 2009, reflecting the fall-off in advances.¹¹⁶

Total System assets surpassed \$1 trillion in 2006 and reached \$1.349 trillion by the end of 2008.¹¹⁷ As the crisis began to subside in 2008, advances and total assets grew at rate of about 6 percent. In 2009, total assets and advances started declining and by the end of the year were down to 2006 pre-crisis levels. This decline was caused primarily by a reduction in advances which fell 32 percent from 2008 to 2009.¹¹⁸

The FHLB System’s holdings of whole mortgages reached a high point at over \$110 billion at the end of 2003 making up about 14 percent of total assets. These holdings had declined by the end of 2009 by roughly half to about \$70 billion or 7 percent of total system assets. At the end of 2010, 7 of the 12 FHL Banks still purchased whole mortgages. According to the Congressional Budget Office (CBO), these mortgages had significantly lower delinquency rates than those guaranteed by Fannie Mae and Freddie Mac. Less than 2.4 percent of the FHL Banks’ mortgage holdings were seriously delinquent at the end of 2009. This compared to 4.8 percent for both Fannie Mae and Freddie Mac. (The rate for the mortgage industry as a whole was 9.7 percent.) FHL Banks’ holdings of private label MBS declined from \$80 billion in 2007 to \$48 billion by the end of 2009.¹¹⁹

Implementation of New Capital Risk Structure

By 2002, capital plans for all 12 FHL Banks were approved by FHFBB and 11 of the 12 banks had implemented their plans. Ten of the 12 capital plans relied completely on class B stock and two included class A stock. Plans for modeling interest-rate risk and procedures for managing such risks by the banks were also required to be submitted to FHFBB.¹²⁰

Expanding the Reach of the Affordable Housing Program

By 2004, some 380,960 units received assistance under the Affordable Housing Program. 70 percent of the units receiving assistance were reserved for very low-income households (at or below 50 percent of area median income).¹²¹ Although establishment of the AHP was highly contentious, by 2005, the program had significant bipartisan support and there was some willingness to discuss expanding the program once the REFCORP payment was satisfied.¹²²

Concerns about Transparency, Effectiveness of Safety & Soundness Oversight, Risks to the Deposit Insurance Fund, Multi-District Membership, the Risks and Appropriateness of New Lines of Business, and Whether the FHLB System is Meeting Its Mission

As the housing GSEs, including the FHLB System, continued to get larger, a number of issues were raised throughout the 2000s relating to the safety and soundness of these institutions. These included the following:

- **Registration with the Securities and Exchange Commission (SEC)** – The G.W. Bush Administration made compliance with the corporate disclosure provisions of the Securities Exchange Act of 1934 by all the GSEs, including the FHL Banks, a high priority. In testimony before the Senate, Wayne Abernathy, the Assistant Secretary for Financial Institutions noted that the FHL Banks were “significant participants” in the capital markets and that even the smallest FHL Bank would rank among the top 40 commercial banks in the U.S. and investors should have the same information regarding the condition of FHL Banks as they have for other participants.¹²³ In 2004, the FHFBB issued a rule requiring the banks to register with the SEC even though their stock is not publicly traded. Registration was completed in 2005.¹²⁴
- **Effectiveness of the FHFBB** – As the FHLB System grew larger, concerns also increased about the capacity and effectiveness of the Federal Housing Finance Board (FHFBB) in conducting safety and soundness oversight over the FHL Banks. A series of GAO reports starting in the 1990s and into the new decade found significant weaknesses in FHFBB’s regulatory oversight program and that involvement in System business functions undermined FHFBB’s independence as a regulator.¹²⁵ In 2003 testimony before the Senate, Sheila Bair, then Professor of Financial Regulatory Policy at the University of Massachusetts, noted that as of February 2003, the FHFBB had only 14 examiners and spent only 36 percent of its budget on supervision. In comparison, other major federal bank regulators would assign teams of 20-30 examiners for *each* of their largest institutions and spent 70-80 percent of their budgets on supervision.¹²⁶ She also noted that the FHFBB had many of the same problems affecting the Office of Federal Housing Enterprise Oversight (OFHEO), the regulator of Fannie Mae and Freddie Mac, and that it was “a small, low-profile agency that simply cannot attract and retain the quality of staff it needs.”¹²⁷
- **Proposals for a Single Regulator of the GSEs** – As noted earlier, reports from the GAO and other organizations in response to a requirement from HCDA of 1992 indicated consolidating regulation of the housing GSEs, including the FHLB System, into one agency would be an option for strengthening safety and soundness oversight. Mixing the regulation of the cooperatively structured FHL Banks with publicly traded companies was a concern as it was felt by many, particularly within the FHLB System, that their cooperative structure discouraged taking excessive risks.¹²⁸ However, as significant financial or accounting problems at the housing GSEs, including the FHL Banks, surfaced early in the decade, pressure increased for consolidation of GSE regulation. Between 2003 and 2005, Standard and Poor downgraded or put on watch lists 7 of the 12 FHL

Banks.¹²⁹ These actions were initiated because of concerns about the ability of the FHL Banks to manage interest rate risks.¹³⁰ Further, substantial investments in mortgages and MBS and competition for members, especially larger banks, may have induced greater risk taking than was commonly assumed making effective regulation more important.¹³¹

In 2000, the Clinton Administration came out in support of a single regulator for the three housing GSEs housed within the Executive Branch.¹³² Similarly, in 2003 and 2005, the Bush Administration supported establishing the new regulator as part of the Treasury.¹³³ In its Guiding Principles for Legislative Reform, the Council of Federal Home Loan Banks, while supporting the concept of one regulator indicated the regulator should be independent “as other bank regulators --- from intervention by any other agency on policy, rulemaking, application, adjudicative and budget matters.”¹³⁴

- **Risks to the Deposit Insurance Fund** – In light of bank and thrift failures in the late 1980s and early 1990s, there was concern that as advances from FHL Banks to their member institutions increased, risks to the FDIC insurance fund were also increasing. This resulted from the fact that if a FHL Bank member failed, the FHL Bank’s “super lien” would place it in a superior position to other creditors, including the FDIC.¹³⁵ An FDIC study found that “advances have increased expected losses by a non-trivial magnitude.”¹³⁶ In 2008, the FDIC issued a notice of proposed rulemaking to increase its premiums on deposit insurance for banks that relied on advances more than the average FHL member bank.¹³⁷ Earlier in the decade, the Clinton Administration had endorsed a repeal of the “super lien” which was included in a GSE regulatory reform proposal sponsored by Representative Richard Baker, Chairman of the House Subcommittee on Capital Markets, Securities and Government Sponsored Enterprises, as a way of promoting market discipline and reducing risk to the bank insurance fund.¹³⁸ But the legislation did not move forward.
- **Multi-District Memberships** – In 2003, the GAO reported that some 100 holding companies had subsidiaries who were members of two or more FHL Bank districts.¹³⁹ At the time, there was a concern that this situation could create a degree of inter-FHL Bank competition because banks could borrow from the FHL Bank offering the least expensive advances.¹⁴⁰ Also, Sheila Bair, in testimony before the U.S. Senate, expressed the concern that multi-district memberships “help only institutions large enough to take advantage of it” and would increase the concentration of advance activity among the largest System members. In 2003, 24 percent of advances went to the Systems top 10 borrowers.¹⁴¹ However, some witnesses at a 2005 House hearing opposed “any” limits on larger member access to FHL Banks indicating that larger members give FHL Banks “critical mass to be strong partners to smaller financial institutions and an important source of affordable housing financing.”¹⁴² Representatives of FHL Banks also cited research sponsored by the Council of Federal Home Loan Banks showing that member institutions held a significantly higher share of their assets in housing and community development loans than non-member institutions.¹⁴³
- **Mortgage Purchase Programs (MPP) and Standby Letters of Credit (SLOCs): Risks and Appropriateness of New Lines of Business** – In 2004, FHFB found risk management problems at the Chicago and Seattle FHL Banks concerning their management of interest rate risks related to mortgage purchases. Both banks were required to submit three year capital and business plans to FHFB and to hire external consultants to review the banks’ management and the oversight activities of their boards. The Chicago bank was required by FHFB to restate its 2003 financial results and the growth of its mortgage purchases was restricted until its risk management practices improved sufficiently. Its program had served as the main vehicle for the growth of mortgage purchase programs within the FHLB System. The Seattle FHL Bank ended its mortgage purchase program.¹⁴⁴ This situation raised issues about the capacity of the FHL Banks to manage such programs and whether they were consistent with the public purpose of the FHLB System. In 2003 testimony before the U.S. Senate, Sheila Bair noted:

“There is nothing in the System’s legislative history or authorizing statute that grants authority for direct mortgage purchases, and that the other two major housing GSEs, that is, Fannie Mae and

Freddie Mac were established and chartered by Congress expressly for that purpose. Congress, not the individual FHL Banks or the FHFB, should decide whether it wants the System to be a major player in the secondary market, and if so, the terms and limitations that should apply.”¹⁴⁵

She also noted that the mortgage purchase programs primarily benefit the System’s largest members.¹⁴⁶ However, other witnesses at the hearing, such as FHFB Chairman John Korsmo, indicated that “the growth of the acquired member asset programs truly reflect a member need.”¹⁴⁷ Further, about the same time as the Senate hearing, the Chair of the House Oversight Committee Richard Baker noted in a press interview that “I don’t see any urgency to constrain (them)” indicating a lack of consensus on goals for the System.¹⁴⁸

Similarly, there is a question of whether the FHLB System’s expansion into the issuing of Standby Letters of Credit (SLOCs) represents an effort to alleviate a market failure or leveraging their borrowing advantages to enter a business that is already competitive and outside the mission of the System. In 1998, FHFB issued a final rule authorizing FHL Banks to offer SLOCs to members and eligible non-member mortgagees. By the end of 2007, the FHL Banks had issued some \$29 billion in SLOCs. However, provisions of federal tax law that required municipal bonds to lose their tax exempt status if they were guaranteed or insured by federal agencies restricted the amount of SLOCs that FHL Banks could issue. A number of federal agencies including FHA, Fannie Mae and Freddie Mac were exempt from these requirements. Over the objection of private sector bond guarantors, the Housing and Economic Recovery Act of 2008 exempted FHL Banks as well. FHL Bank issues of SLOCs had increased to nearly \$50 billion by the end of 2008.¹⁴⁹

- **Extent to which the FHLB System is Meeting Its Mission** – The advances provided through the FHLB system are intended to support members’ financing of housing and community development activities. Nevertheless, the advances are fungible and some research indicates that advances may be as likely to support other types of credit activity as mortgages for residential housing.¹⁵⁰ However, a 2002 study from the Federal Reserve Bank of Cleveland found a significant positive relationship between a bank’s use of advances and its mortgage finance activity.¹⁵¹ In 2005, two papers sponsored by the Council of Federal Home Loan Banks found additional evidence of a positive relationship between use of advances and housing and community development activities. FHL Bank members were found to hold a significantly greater proportion of their portfolios in mortgage loans and community development loans than non-members, regardless of the size of the institution.¹⁵² Also, members with assets over \$10 billion that are in the upper quartile of advance users held a significantly higher percentage of their portfolios in residential mortgages than smaller institutions or other users and non-users of the same size.¹⁵³ A comparative analysis of FHL Bank member mortgage originations and sales with those of non-members and purchases of loans made by Fannie Mae and Freddie Mac found that FHL members have higher overall origination rates and higher minority origination rates than do non-members and FHL Bank members originate affordable lending goal qualifying mortgages at a higher rate than do non-members. The top quartile of advance users did best overall in originating goal qualifying mortgages.¹⁵⁴

A 2003 study found that increasing access to advances did not increase the amount of small business and agricultural loans made by community financial institutions pursuant to recently enacted provisions of the GLBA and that advances might not be the most effective intervention to achieve these goals.¹⁵⁵ By 2005, only about 1 percent of System collateral was pledged to secure advances funding these activities.¹⁵⁶ However, misunderstanding about the requirements or a lack of familiarity among member institutions may account for the lack of use by member institutions and FHFB was undertaking outreach activities on this issue.¹⁵⁷

An Important Provider of Liquidity to Depository Institutions during the Financial Crisis

In first half of 2007, the FHLB System became an “important provider of government sponsored liquidity” for depository institutions as much of the Federal Reserve’s initial liquidity efforts were for the benefit of non-depository or foreign financial institutions.¹⁵⁸ At the start of the crisis, FHLB advances proved to be a less expensive option than the Federal Reserve’s discount window.¹⁵⁹ Had depository institutions turned to the Federal Reserve instead of the FHLB System, the Federal Reserve would have faced significant demand for borrowing at the Discount Window much sooner in the crisis. In this sense, the two systems complemented each other in responding to the crisis but it also illustrated the fragmented nature of the regulatory system for financial institutions.¹⁶⁰ However, the fact that the System’s ten largest borrowers received 63 percent of advances (\$150 of the \$235 billion) provided during the second half of 2007 and included among them was Washington Mutual and Countrywide, raised questions about the efficacy and direction of the FHLB System.¹⁶¹

Concerns about Access to Advances by Failing Institutions and Those Engaged in Risky or Predatory Practices

In 2007, Sen. Charles Schumer criticized advances made to Countrywide Bank by the FHL Bank of Atlanta stating that the bank was serving as Countrywide’s “personal ATM” and that the advances posed an “unreasonable risk” because Countrywide was a major seller of risky payment-option-adjustable rate mortgages (option ARMS).¹⁶² A key implication of these statements was that the advances to Countrywide contributed to the foreclosure crisis. However, a review of the FHLB System’s collateral and oversight policies by Hoffman and Cassell found the following:

- **No Weakening of Collateral Requirements** – Discounts are applied to the value of collateral by FHL Banks when selling advances to members. This process is known as a “haircut” and protects the Banks from losses associated with these transactions.¹⁶³ Over collateralization and discounting protect the banks against losses associated with the sale of advances. The chief forms of collateral were conventional mortgages and multifamily loans (although subprime loans were not prohibited as collateral) according to FHFA annual reports for 2007 and 2008. Further, in April of 2007, FHFBA issued a bulletin in response to increased foreclosures. This required FHL Banks to review current credit risk management policies and adopt additional policies concerning nontraditional and subprime mortgages. It also required each FHL Bank to verify that member institutions were in compliance with federal and state lending rules regarding these types of mortgages. In addition, collateral verification reviews were put in place by the FHL Banks for each type of collateral including continuous on-site monitoring by FHL Bank staff. The review did not find any evidence from Inspector General reports or studies by academics or other government agencies indicating that a significant lowering of collateral standards took place.¹⁶⁴
- **Conforming Fixed Rate Loans Purchased under FHLB Mortgage Purchase Programs & Investment Portfolios of FHL Banks** – Almost 100 percent of the loans purchased under the FHLB mortgage purchase programs were conforming fixed rate conventional loans. The average FICO scores for MPP and MPF were 749 and 738 respectively in 2007 and LTV ratios were 71 and 67 percent, consistent with the typical range for conforming mortgages.¹⁶⁵ In 2007, MBS comprised 48 percent of FHL Bank investments (about a quarter of total assets were investments) but less than 2 percent of FHL Bank MBS investments were characterized as subprime according to the FHFBA annual report.¹⁶⁶ However, the review indicated that it could not be confirmed whether advances to Countrywide or Indy Mac used subprime MBS as collateral until the results from a study mandated by the Housing and Economic Recovery Act of 2008 (HERA) were available.¹⁶⁷
- **Effects of Advances on Bank Risks Are Modest** – Research studying the effects of advances between 1992 and 2005 on bank risk-taking found liquidity and leverage risks “rose modestly” for FHLB members but interest-rate risk “declined somewhat.” Further, credit risk and overall insolvency risk were “largely unaffected.”¹⁶⁸ Therefore, it seemed that the availability of advances had

only “modest” impact on bank risk.¹⁶⁹ But the authors noted that could change if leverage ratios were to decline in a time of financial distress.¹⁷⁰

- **Federal Housing Finance Agency (FHFA) Study on Federal Home Loan Bank Collateral for Advances and Interagency Guidance on Nontraditional Mortgage Products** – In July, 2009, a study on the extent to which collateral used to support FHLB advances were consistent with interagency guidance on nontraditional mortgage products was released by FHFA. The study found that subprime, nontraditional and Alt-A loans and subprime private-label and Alt-A MBS made up 34.5 percent of the collateral supporting FHLB advances at the end of 2007. (However, an unknown share of the loans or MBS in these categories may have been originated or issued prior to release of the guidance on July 10, 2007 and therefore are not counted in the study.) This declined to 20.5 percent by the end of 2008.¹⁷¹ 32.5 percent of the collateral at the Atlanta FHL Bank was in these categories by the end of 2008.¹⁷² Credit reviews indicated weaknesses in policies and practices concerning the management of risks associated with this type of collateral. FHFA indicated it would clarify that FHFB guidance applies to MBS purchased after July 10, 2007 and adoption by Congress of a borrower’s ability to repay as a minimum legal standard.¹⁷³

The Housing and Economic Recovery Act of 2008 (HERA)

On July 30, 2008, President George W. Bush signed HERA into law. The Act restructured the regulation of the housing GSEs including the Federal Home Loan Banks by establishing a new independent regulator, the Federal Housing Finance Agency (FHFA). The Act gives the FHFA authority to ensure the safety and soundness of the GSEs including the power to:

- Set capital standards,
- Set prudential management standards,
- Enforce orders through cease and desist authority, civil money penalties, and the power to remove officers and directors,
- Limit asset growth and capital distributions for undercapitalized institutions,
- Place a regulated entity into receivership, and
- Review and approve new product offerings of the enterprises.¹⁷⁴

With regard to the FHLB System, the Act included the following:

- **Structure and Regulation** – Recognized the cooperative structure of the FHLB system including provisions establishing a separate deputy director for FHLB regulation and a requirement that regulations take into account the ownership structure, mission, capital structure, and joint and several liability of the Banks.
- **Affordable Housing Goals** – Required new affordable housing goals like those that apply to the Fannie Mae and Freddie Mac with regard to the FHLB System mortgage purchase programs and development of a public use data base for these programs.
- **Membership** – Treasury certified Community Development Financial Institutions were made eligible to join FHL Banks and the size of bank eligible to join the FHLB Community Financial Institutions program was increased from \$600 million in assets (adjusted for inflation) to \$1 billion.
- **Tax Exempt Bonds** – Municipal bonds guaranteed by the FHL Banks will be eligible for treatment as tax exempt bonds. As noted previously, prior to passage of HERA, municipal bonds guaranteed by FHL Banks could not qualify as tax-exempt bonds unless the bonds were used to finance housing programs. HERA allows state and local governments to access lower cost financing offered by FHL Banks for community development projects regardless of whether the bonds are used to finance housing.¹⁷⁵

Recent Developments: 2010 to the Present

System Advances and Assets Decline from 2010 to 2012 but Start Increasing in 2012

System advances declined from \$463.9 billion at the end of 2010 to \$413.4 billion at the end of 2012. However, subsequently there have been three years of increases by year end 2014. The increase in 2014, by \$72 billion to \$570.7 billion, was the largest since 2007 when the liquidity crisis led to large scale borrowing by members.¹⁷⁶ Total System assets declined from \$1.015 trillion at the end of 2009 to \$878.1 at the end of 2012 to \$762.6 billion at the end of 2012. At the end of 2014, they had increased to \$913.3 billion from \$834.2 billion at the end of 2013, a 9.5 percent increase.¹⁷⁷

Demand for Advances Concentrated Among Largest Members

The demand for advances have been concentrated among the largest bank holding companies. FHFA notes that the top four bank holding companies – Bank of America, Citigroup, J.P. Morgan Chase, and Wells Fargo – received 27 percent of aggregate advances by the end of 2014.¹⁷⁸ Among the two largest FHL Banks, Atlanta and New York, the banks’ ten largest borrowers held 75 and 73 percent respectively of total advances.¹⁷⁹ At the smallest FHL Bank, Topeka, this figure was 56 percent.¹⁸⁰ Among all district FHL Banks, the Cincinnati bank had the highest concentration of advances, 84 percent, held among the ten largest borrowers. The Dallas bank, with 39 percent, had the lowest.¹⁸¹

Earnings from Investments & Mergers of FHL Banks

Some 30 percent of total FHL Bank assets were investments but at individual banks they were as high as 68 percent at the end of 2014. Demand for advances is low in some FHL Bank districts creating a challenge for these institutions to continue focusing on their primary mission while earning enough income to cover operating expenses and remain profitable.¹⁸² This may increase pressure for consolidations of district banks. In 2011, FHFA issued a rule on voluntary mergers among FHL Banks and established an approval process for such mergers. On May 31, 2015, the FHL Banks of Des Moines and Seattle were merged to form a single bank.¹⁸³

FHFA Rule on Federal Home Loan Bank Membership

Changes in the financial services industry raised a number of concerns that the existing membership rule did not sufficiently address. These included making sure that the existing membership rule was effectively implementing the statutory “10 percent,” “makes long-term home mortgage loans,” and “home financing policy” eligibility requirements and preventing circumvention of statutory membership restrictions by ineligible entities using “captive insurers” as conduits for membership. In 2010, FHFA began a review of its membership rule and issued an advance notice of rulemaking (NPR) asking if more objective and quantifiable standards were needed and whether any or all of those requirements should apply on a continuing basis rather than just at the time of applying for membership.¹⁸⁴

After receiving public comments on the NPR and giving the issues further study, FHFA issued a proposed rule on September 12, 2014 which included the following:

- **FHL Bank Member Investment Requirements** – The proposed rule required that a member institution hold at least one percent of its assets in home mortgage loans in order to satisfy the statutory “makes long-term home mortgage loans” requirement and to require that each Bank member comply with the “one percent” requirement and with the “10 percent” percent requirement on an ongoing basis, as applicable. FHL Banks would have been required to determine member compliance annually using data from financial reports to calculate necessary ratios on a three-year rolling average. If found to be out of compliance with either requirement, members would be given one year to return to compliance or face termination of membership.¹⁸⁵

- **Definition of Insurance Company** – The proposed rule defined the term “insurance company” (not defined in existing rules or statute) to exclude captives, making them ineligible for membership. Further, it defined “insurance company” to mean “a company whose primary business is the underwriting of insurance for *nonaffiliated* persons or entities.” (italics added) Captives admitted to membership prior to adoption of the rule (some 40 in September, 2015.) could remain a member for five years but the proposed rule limited the amount of advances of such a member to 40 percent of the member’s total assets and prohibited new advances or renewing an existing advance with a maturity date beyond the five year grace period.¹⁸⁶
- **MBS, Audited Financial Statements, Principle Place of Business** – The proposed rule expanded the list of assets that qualify as “home mortgage loans” to include all types of MBS, required that a FHL Bank examine an insurance company applicant’s most recent audited financial statements to determine whether it met the “financial condition” requirement and revised how a FHL bank would determine the “principle place of business” of insurance companies or CFDIs by where it actually conducts business.¹⁸⁷

The number of entities that were ineligible for membership, particularly real estate investment trusts (REITs) establishing captive insurance companies to obtain access to low cost advances had increased significantly in recent years. Since mid-2012, 27 new captive insurers had been admitted as FHL Bank members and 25 of them were owned by entities that were not themselves eligible for membership.¹⁸⁸ Advances obtained by these members were disproportionately large in comparison with their investments and operations and led FHFA to conclude that the true purpose of the arrangements was to provide ineligible REITs with access to FHL bank funding. FHFA also noted organized efforts by consultants and state insurance regulators to promote such memberships.¹⁸⁹

The proposed rule was strongly opposed by the Council of Federal Home Loan Banks, the community banking industry, and almost all commenters.¹⁹⁰ After reviewing the comments, FHFA determined that over 98 percent of current members would likely be in compliance with the investment requirements and its concerns about members reducing their commitment to housing finance could be met “by continuing to monitor the levels of residential mortgage assets held by members.”¹⁹¹ A final rule without the investment requirements was issued on January 20, 2016. Legislation was introduced in Congress to stop the FHFA from finalizing its rule.¹⁹²

The FHL Banks and Housing Finance Reform

In February, 2011, the U.S. Departments of Treasury and Housing and Urban Development released *Reforming America’s Housing Finance Market, A Report to Congress*. While focused primarily on reforms relating to Fannie Mae and Freddie Mac, the report included a number of proposals concerning the FHL Banks. These included the following:

- **Multi-Districts Memberships** – The Administration supported allowing each FHL Bank member to be active in *only one* FHL Bank (italics added).
- **Limiting Advances** – The Administration supported limiting the amount of advances for larger institutions since they already have access to capital markets.
- **Reducing Portfolio Investments** – Noting that several FHL Banks had built up large investment portfolios similar to Fannie Mae and Freddie Mac, the Administration supported reducing them and changing their composition to better serve the FHLB’s mission of providing liquidity and access to capital for insured depository institutions.
- **FHFA Membership Rule** – The Administration indicated it supported FHFA efforts to focus the System on its housing finance mission and clarify the FHL Banks investment authority.¹⁹³

In testimony before the House Committee on Financial Services, Lee Gibson, the Chairman of the Council of Federal Home Loan Banks stated concern about the Administration proposals “which included several proposed changes to our unique structure.” He also noted that advances to large members were “mission consistent” and their participation in the FHLB System reduces costs for the smaller institutions and they did not have disproportionate influence because of the Banks’ voting systems.¹⁹⁴ Bruce Morrison, a former Member of Congress and former Director of the FHFB noted that the larger banks were receiving a substantial subsidy through advances they received and he would condition those loans on their financing “a very specific kind of illiquid asset.”¹⁹⁵ Timothy Zimmerman, a representative of the Independent Community Bankers of America (ICBA) also noted strong opposition to the investment test in the proposed FHFA membership rule as well as any proposals to merge the FHLB system into any replacement for Fannie Mae and Freddie Mac.¹⁹⁶

In October 2013, the Council of Federal Home Loan Banks issued a position paper in response to various housing finance reform proposals under consideration in Congress. It included the following positions:

- **Cooperative Structure** – The core strength of the FHL Banks is their member-driven cooperative structure.
- **Role of FHL Banks** – The preservation of the FHL Banks’ role, under their traditional structure and charter, to support housing and provide lower-cost funding and liquidity to their members through secured wholesale lending and other products, programs and services.
- **Mortgage Purchase Programs** – The FHL Banks must have the authority to build upon existing mortgage programs to improve their members’ access to the secondary markets.
- **Authorize Mortgage Securitization** – Support the provision of statutory authority to allow the FHL Banks the option to securitize mortgage loans.
- **Affordable Housing Program** – Support the preservation of the FHL Banks’ Affordable Housing Program (AHP), which is based on a set-aside of 10 percent of earnings and administered through members.
- **FHL Bank Portfolio Investments** – Support the preservation of the existing investment authorities so that members and partners can, in all economic conditions, rely on the benefits of the FHL Banks.
- **Membership Qualifications** – Support the preservation of the existing qualifications for FHL Bank membership and members’ access to all FHL Bank services.
- **Stand Alone Regulator** – Support the concept of a single stand-alone regulator for the FHL Banks.¹⁹⁷

The Federal Mortgage Insurance Corporation provision in the Corker Warner housing reform proposal was seen by some as a vehicle for the FHLB Banks to fulfill the securitization needs of community banks and credit unions by serving as the main aggregator for smaller mortgage originators and in issuing “covered” bonds.¹⁹⁸ Housing finance reform was also seen as an opportunity to introduce efficiencies into the FHLB System through consolidation and the use of technology and changes to the System should be included in the housing finance reform debate.¹⁹⁹

Completion of the REFCORP Payment Obligation

On August 5, 2011, the FHFA announced that the FHLB System had fulfilled its obligation to pay interest on the Resolution Funding Corporation (REFCORP) bonds. It also announced approval of capital plans for the FHL Banks to direct funds used previously to pay interest on REFCORP bonds to new restricted retained earnings accounts in order to increase the Banks’ retained earnings and capital. 20 percent of each FHL Bank’s net income will be placed in its restricted retained earnings account until the account equals one percent of that Bank’s outstanding consolidated obligations. Banks are prohibited from paying dividends out of the restricted retained earnings account.²⁰⁰

However, as noted by Bruce Morrison in testimony before the House Committee on Financial Services, allocating these funds to building capital instead of allocating a portion to the Affordable Housing Program essentially diverted these funds to private rather than public purposes.²⁰¹

The Affordable Housing Program (AHP)

Some \$4.8 billion was allocated to the AHP by the FHL Banks from 1990 to 2014. In 2014, they awarded \$328 million in AHP funds.²⁰² Despite initial opposition by the FHL Banks and many in Congress, the program has been deemed a major success by the FHL Banks and enjoys bipartisan support. However it is small relative to the amount of advances and size of the System.²⁰³ Also, some local partners may find the burden of program requirements disproportionate to the amount of investment provided and some requirements may be incompatible with other programs and funding sources.²⁰⁴ The Office of the Inspector General at FHFA found that oversight of the program could be improved through provision of cross-cutting data or trend analysis as well as more visits to project sites.²⁰⁵

Issues/Implications

Role of Large Banks in the System

FHLB System advances reached a high point in 2008 at about \$1 trillion as a result of the financial crisis. But they decreased by 62 percent to \$381 billion by the end of 2012.²⁰⁶ Since that time, however, System advances have been increasing, reaching \$566 billion by the end of 2014.²⁰⁷ An increase in advances to the four largest members of the FHLB System: JP Morgan Chase, Bank of America, Citigroup, and Wells Fargo has largely driven this growth. In contrast, the level of advances for all other FHLB members is relatively flat.²⁰⁸ As noted earlier, advances to these four megabanks accounted for over a quarter (27 percent) of all system advances in 2014.²⁰⁹

It is doubtful that in 1932 or 1989 Congress intended the FHL Banks to be wholesale lenders to the nation's largest banks but that was the result of opening membership in the System to commercial banks and increasing consolidation in the financial services industry. Serving the needs of small community banks is unlikely to cause FHL Banks to be diverted from their statutory purposes. But large national banks have other ways of accessing capital markets. The rationale of GLBA was that by allowing large firms to form they would be better able to function in the new financial services environment without needing to rely heavily on public infrastructure and help.²¹⁰

As noted by Morrison, the multi-district membership issue is “a product of the outsized importance of very large institutions in the system.”²¹¹ Some 49 financial companies now operate in two or more FHL Bank Districts through separately chartered subsidiaries.²¹² As noted previously, smaller community banks are not advocating for removal of large members from the FHLB System. In fact, just the opposite as the presence of large members provides earnings and lower cost of funds benefits. However, current housing/membership investment tests are easy to meet and large members benefit especially from GSE cost of funds that provide a lower-cost liquidity alternative to other capital market sources.²¹³ The fact that filings with the Securities and Exchange Commission indicate that JP Morgan Chase used its recent purchases of advances to meet Basel III requirements emphasizes this point.²¹⁴

Pressure on FHL Banks for Earnings and Dividends

Since 1990, the FHL Banks have been under increased pressure for dividends and competitive pricing for advances to attract and retain members as well as earnings to meet required capital levels.²¹⁵ These pressures are exacerbated by concentration of advances to large members. Some FHL Banks may be overly dependent on interest income generated by advances to large members. Further, the interest rates that larger members pay on their advances have declined even while their advance balances have grown substantially.²¹⁶

Such tensions have increased the FHL Banks' attention to the investment portion of their balance sheets. As noted earlier, the purchase of MBS was less a public purpose in support of the System's housing mission than a profitable arbitrage based on the Banks' cost of funds resulting from their GSE status.²¹⁷ Further, the increased interest rate risk associated with some of these investments has been a management challenge for a number of the banks. At some banks, investments make up a very high proportion of their assets raising questions about their viability and public purpose.

Future of the Affordable Housing Program (AHP)

Given the initial strong opposition to the AHP, the level of support now enjoyed by the program is remarkable. However, the program is relatively small (\$328 million in 2014) given the overall size of the FHLB System (\$913.3 billion). Further, as Morrison notes, it is a “useful bi-product that exists because of a Congressional mandate rather than a justification for the FHLB System.”²¹⁸ Given the failure of the very

minimal member investment test under FHFA's proposed rule on membership, it seems that direct contributions to affordable housing, particularly to meet the current crisis among low-income households, could be increased substantially once restricted retained earnings reach one percent of consolidated obligations. Further, there should be some consideration of whether having the FHL Banks direct their contribution to the National Housing Trust Fund, like the other housing GSE's, rather than running district based programs would be a more effective use of the resources.

The Role of the FHL Banks in the National Housing Finance System

The implied warranty that previously supported Fannie Mae and Freddy Mac continues to support the FHLB System. Yet there has been relatively little consideration of the role the FHL Banks might play in a restructured national housing finance system and whether the implied warranty and other benefits of GSE status should be retained.²¹⁹ This may result in part from the fact that community banks and the FHL Banks themselves would appear to prefer that changes to the FHLB System be dealt with largely outside the context of housing finance reform.²²⁰ While the advance business is ordinarily low risk if a new era of instability and bank failures were to occur, taxpayers could end up paying the bill as in 2008.²²¹

The debate on a restructured national housing finance system would also offer the opportunity to reevaluate the mortgage purchase programs operated by the FHL Banks in light of assuring market access and consider what role the FHL Banks might play in a new system as mortgage aggregators and in securitization for smaller financial institutions.²²²

Endnotes

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- ¹ Federal Housing Finance Agency, *FHFA 2014 Report to Congress*, p. 18; <http://www.fhfa.gov/AboutUs/Reports/Pages/Annual-Report-to-Congress-2014.aspx>
- ² *Ibid*, p. 80 & 97.
- ³ Frame, W.S. and White, L.J., *The Federal Home Loan Bank System: Current Issues in Perspective*, Reforming Rules and Regulations, MIT Press, 2010, p. 1. See also footnote 1 in which authors cite the relative lack of academic studies. <https://ideas.repec.org/p/ste/nystbu/09-18.html>
- ⁴ Ashcraft, A.B., Bech, M.L. and Frame, W.S. *The Federal Home Loan Bank System: The Lender of Next-to-Last Resort?* Staff Report 357, Federal Reserve Bank of New York, November 2008, p. 6; https://www.newyorkfed.org/research/staff_reports/sr357.html Until 2015, there were 12 FHLBs. However, on May 31, 2015, the banks of Des Moines and Seattle merged to form a single bank. See Federal Housing Finance Agency, *FHFA 2014 Report to Congress*, p. 22.
- ⁵ Ashcraft, A.B., Bech, M.L. and Frame, W.S., p. 6.
- ⁶ Federal Housing Finance Agency, p. 20.
- ⁷ *Ibid*, p. 18 & 21.
- ⁸ *Ibid*, p. 18-19, at the end of 2014, the aggregate investment portfolio of the FHL Banks consisted of 36 percent cash and liquidity, 41 percent agency and Ginnie Mae mortgage backed securities, 6 percent private label securities and 17 percent other investments principally agency backed securities and federally backed student loan asset-backed securities.
- ⁹ As of July 15, 2011, the FHL Banks satisfied their statutory obligation to contribute a percentage of their annual net earnings toward the interest payments due on bonds issued by the Resolution Funding Corporation (RefCorp). See Federal Housing Finance Agency (No. 2011-N-08), *Termination of Federal Home Loan Bank Resolution Funding Corporation Obligation*, Federal Register, Vol. 76, No. 154/ Wednesday, August 10, 2011/ Notices, p. 49477. <https://www.federalregister.gov/documents/2011/08/10/2011-20311/termination-of-federal-home-loan-bank-resolution-funding-corporation-obligation>
- ¹⁰ Federal Housing Finance Agency, *FHFA 2014 Report to Congress*, p. 48
- ¹¹ *Ibid*, p. 50
- ¹² Congressional Research Service, *Federal Home Loan Bank System: Policy Issues*, by Edward V. Murphy, Analyst in Financial Economics, 2008, p. 4; <http://congressionalresearch.com/RL32815/document.php?study=Federal+Home+Loan+Bank+System+Policy+Issues>; Frame, W.S. and White, L. J., p. 3; and Flannery, M.J. and Frame, W.S., *The Federal Home Loan Bank System: The "Other" Housing GSE*, Federal Reserve Bank of Atlanta Economic Review, Third Quarter of 2006, p. 36.
- ¹³ Congressional Research Service, p. 3; https://www.frbatlanta.org/research/publications/economic-review/2006/q3/vol91no3_federal-home-loan-bank-system.aspx
- ¹⁴ Frame, W.S. and White, L.J., p. 3.
- ¹⁵ Ashcraft, A.B., Bech, M.L. and Frame, W.S., p. 8.
- ¹⁶ Federal Housing Finance Agency, p.69, the statutory minimum leverage ratio is 4 percent. Also see Congressional Research Service, p. 3 regarding leverage ratio for commercial banks.
- ¹⁷ Frame, W.S. and White, L.J., p. 1.
- ¹⁸ Zigas, B., *Re-engineering the Mortgage Finance System: Charting a Future Course for the Secondary Market*, Consumer Federation of America, 2009, p. i; http://consumerfed.org/wp-content/uploads/2010/09/Reengineering_the_mortgage_finance_system.pdf
- ¹⁹ Hoffmann, S.M. and Cassell, M.K., *Mission Expansion in the Federal Home Loan Bank System*, State University of New York Press, 2010, p. 29.
- ²⁰ Hoffmann, S.M. and Cassell, M.K., p. 30.
- ²¹ *Ibid*, p. 31-32.
- ²² *Ibid*, p. 33.
- ²³ *Ibid*, p. 33-34.
- ²⁴ *Ibid*, p. 35.
- ²⁵ *Ibid*, p. 33.
- ²⁶ *Ibid*, p. 38.
- ²⁷ *Ibid*, p. 36.
- ²⁸ *Ibid*, p. 37-38.
- ²⁹ *Ibid*, p. 37.
- ³⁰ Frame, W.S. and White, L.J., p. 5-6.
- ³¹ Hoffmann, S.M. and Cassell, M.K., p. 37.
- ³² *Ibid*, p. 35.
- ³³ *Ibid*, p. 41-43.
- ³⁴ *Ibid*, p. 43-45.
- ³⁵ Frame, W.S. and White, L.J., p. 6 and FDIC *Historical Timeline*; <https://www.fdic.gov/about/history/timeline/1930s.html>
- ³⁶ Hoffmann, S.M. and Cassell, M.K., p. 45.
- ³⁷ Frame, W.S. and White, L.J., p. 6 and 26 (Table 3).
- ³⁸ Hoffmann, S.M. and Cassell, M.K., p. 45 and 154 see footnote 35.
- ³⁹ *Ibid*, p. 46-48.
- ⁴⁰ *Ibid*, p. 49-50, also see Frame, W.S. and White, L.J., p. 7.
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- ⁴² Ibid, p. 53 and p. 157 see footnote 52.
- ⁴³ Ibid, p. 50.
- ⁴⁴ Frame, W.S. and White, L.J., p. 7 and 26.
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- ⁴⁶ U.S. Government Accountability Office (GAO-05-489T), *Federal Home Loan Bank System, An Overview of Changes and Current Issues Affecting the System*, Testimony Before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, Statement of Thomas J. McCool, Managing Director, Financial Markets and Community Investment, April 13, 2005, p. 6-7; <http://www.gao.gov/products/GAO-05-489T>
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- ⁴⁸ Frame, W.S. and White, L.J., p.8.
- ⁴⁹ U.S. Government Accountability Office (GAO-05-489T), p. 7.
- ⁵⁰ Hoffmann, S.M. and Cassell, M.K., p. 51.
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- ⁵² House Report #54, 101st Cong., 1st Sess., 1989, p. 456.
- ⁵³ Ibid, p. 457.
- ⁵⁴ Hoffmann, S.M. and Cassell, M. K., p. 53-54.
- ⁵⁵ House Report #54, p. 457.
- ⁵⁶ Congressional Record, 101st Cong., 2d sess., 1989, 135, 80: H2767, 2771, 2773, See remarks of Representatives Gonzalez, Frank, Morrison, and Carper. See also House Report #54, p. 546-547, Supplemental Views on Low-Income Housing Provision in H.R. 1278 of Representatives Vento, Neal and Pelosi. See also Hoffmann, S.M. and Cassell, M.K., p. 77.
- ⁵⁷ Ibid, H2767 and Hoffmann, S.M. and Cassell, M.K., p. 73.
- ⁵⁸ Hoffmann, S.M. and Cassell, M.K., p. 73.
- ⁵⁹ Ibid, p. 78 and Congressional Record, H 2766-2767.
- ⁶⁰ Congressional Record, H2776.
- ⁶¹ Hoffmann, S.M. and Cassell, M.K., p. 74.
- ⁶² House Report #54, p. 459.
- ⁶³ Hoffmann, S.M. and Cassell, M.K., p. 74.
- ⁶⁴ Ibid. The new program was modeled on the Community Investment Fund (CIF) which was started in 1978 by the Federal Home Loan Bank Board. At the time of the enactment of FIRREA, ten of the twelve FHL Banks had CIF programs although most were characterized as “very modest” in the House Report. See House Report #54, p. 457 and 547. See also Hoffmann, S.M. and Cassell, M.K., p. 79.
- ⁶⁵ Ibid, p. 74-75.
- ⁶⁶ Ibid, p. 75.
- ⁶⁷ Ibid and House Report #54, p. 460. The House report notes that the change to FHL Bank Directors was made “with the intent of giving the housing community a voice in the allocation of credit to that community.”
- ⁶⁸ House Report #54, p. 460.
- ⁶⁹ Hoffmann, S.M. and Cassell, M.K., p. 75 and House Report #54, p. 460.
- ⁷⁰ House Report #54, p. 460.
- ⁷¹ Congressional Record, H2768 and Hoffmann, S.M. and Cassell, M.K., p. 76.
- ⁷² Congressional Record, H2775, see remarks of Rep. Kleczka discussing *Fahy et al v. O'Melveny*.
- ⁷³ Frame, W.S. and White, L.J., p. 9.
- ⁷⁴ Ibid, p. 26.
- ⁷⁵ Hoffmann, S.M. and Cassell, M.K., p. 54-56.
- ⁷⁶ Ibid, p. 102.
- ⁷⁷ U.S. Government Accountability Office (GAO-05-489T), p. 13. Through 2004, member thrifts accounted for 43percent of all system capital and 50 percent of all advances.
- ⁷⁸ Hoffmann, S.M. and Cassell, M.K., p. 54.
- ⁷⁹ Ibid, p. 5 and 99.
- ⁸⁰ Stojanovic, D., Vaughan, M.D. and Yeager, T.J. *Is FHLB Funding a Risky Business for the FDIC?* Federal Reserve Bank of St. Louis, October 2000; <https://www.stlouisfed.org/publications/regional-economist/october-2000/is-federal-home-loan-bank-funding-a-risky-business-for-the-fdic>
- ⁸¹ Ibid. Also see Barrons, *Bank Chief Hits at Rubin, Secretary Faulted for Killing Home Loan Bill*, by Jim McTague August 10, 1998; <http://www.barrons.com/articles/SB902530148728426500> and Hoffmann, S.M. and Cassell, M.K., p. 5.
- ⁸² U.S. Government Accountability Office (GAO-05-489T), p. 14-15. Also, see Frame, W.S. and White, L.J., p. 26. By 2000, advances had increased to 67 percent of assets and membership to 7,777.
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- ⁸⁴ Hoffmann, S.M. and Cassell, M.K., p. 55.
- ⁸⁵ Congressional Budget Office, p.xiii.
- ⁸⁶ U.S. Government Accountability Office (GAO-05-489T), p. 10.
- ⁸⁷ Hoffmann, S.M. and Cassell, M.K., p. 57.
- ⁸⁸ U.S. Government Accountability Office (GAO-05-489T), p. 10.
- ⁸⁹ Ibid, p. 16.

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- ⁹⁰ Hoffmann, S.M. and Cassell, M.K., p. 122-123.
- ⁹¹ Ibid, p. 80-81.
- ⁹² Ibid, p. 90.
- ⁹³ Ibid, p. 86.
- ⁹⁴ U.S. Government Accountability Office (GAO/GGD-94-38), *Federal Home Loan Bank System, Reforms Needed to Promote Its Safety, Soundness, and Effectiveness*, Report to the Chairman, Committee on Banking, Housing and Urban Affairs, U.S. Senate and the Chairman, Committee on Banking, Finance and Urban Affairs, Housing of Representatives, December, 1993, p. 8; <http://www.gao.gov/products/GGD-94-38>
- ⁹⁵ Hoffmann, S.M. and Cassell, M.K., p. 99-100.
- ⁹⁶ Ibid, p. 110.
- ⁹⁷ Ibid, p. 103.
- ⁹⁸ Ibid, p. 105.
- ⁹⁹ U.S. Government Accountability Office (GAO/GGD-94-38), p. 11. Other groups included the Congressional Budget Office, the FHFB and the Federal Home Loan Banks Stockholder Study Committee. The GAO report indicates there were no major objections to the GAO findings and recommendations from the other groups.
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- ¹⁰¹ Congressional Budget Office, p. xiv.
- ¹⁰² Ibid
- ¹⁰³ U.S. Government Accountability Office (GAO/GGD-94-38), p. 4, 6-7.
- ¹⁰⁴ Ibid, p. 4, 7-8. See also Congressional Budget Office, p. xvi.
- ¹⁰⁵ Ibid, p. 4.
- ¹⁰⁶ Congressional Budget Office, p. xvi.
- ¹⁰⁷ U.S. Government Accountability Office (GAO/GGD-94-38), p. 9.
- ¹⁰⁸ Ibid, p. 9-10.
- ¹⁰⁹ U.S. Government Accountability Office (GAO-05-489T), p. 7-8.
- ¹¹⁰ Ibid, p. 16.
- ¹¹¹ Ibid.
- ¹¹² Ibid, p. 8.
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- ¹¹⁴ Ibid, p. 107.
- ¹¹⁵ Thomson, J. B. and Koepke, M. , *Federal Home Loan Banks: The Housing GSE That Didn't Bark in the Night?*, Federal Reserve Bank of Cleveland, September 23, 2010, and Federal Housing Finance Agency, p. 109; <https://www.clevelandfed.org/en/newsroom-and-events/publications/economic-trends/economic-trends-archives/2010-economic-trends/et-20100923-federal-home-loan-banks-the-housing-gse-that-didnt-bark-in-the-night.aspx>
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- ¹¹⁷ Federal Housing Finance Agency, p.109.
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- ¹²² Ibid, p. 29 and 43. See remarks of Representatives Frank and Baker.
- ¹²³ U.S. Senate Hearing 108-834, *Oversight of the Federal Home Loan Bank System*, Before the Subcommittee on Financial Institutions, Committee on Banking, Housing, and Urban Affairs, September 9, 2003, Statement of Wayne A. Abernathy, Assistant Secretary for Financial Institutions, U.S. Department of the Treasury; <https://www.gpo.gov/fdsys/pkg/CHRG-108shrg21384/html/CHRG-108shrg21384.htm>
- ¹²⁴ U.S. House Hearing 109-6, p. 72-73.
- ¹²⁵ U.S. General Accounting Office (GAO/GGD-98-203), *Federal Housing Finance Board Actions Needed to Improve Regulatory Oversight*, Report to the Chairman, Subcommittee on Capital Markets, Securities and Government Sponsored Enterprises, Committee on Banking and Financial Services, House of Representatives, September, 1998, p. 5-8; <http://www.gao.gov/products/GGD-98-203> GAO found that in each of the exams it reviewed, more than half of the areas of examination were not conducted in accordance with FHFB standards and examiners did not expand the examination when potentially serious problems were found. GAO had previously issued reports in 1991 (GAO/GGD-91-90), 1994 (GAO/GGD-94-38) and 2001 (GAO-01-873) with similar findings. Also see U.S. Government Accountability Office (GAO-05-489T), p. 4 for listing of additional GAO reports during this time period.
- ¹²⁶ U.S. Senate Hearing 108-834, Prepared Statement of Sheila C. Bair and response to written questions of Senator Sarbanes.
- ¹²⁷ Ibid.
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- ¹²⁹ Flannery, M.J. and Frame, W.S., p. 34.
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- ¹³¹ Ibid, p. 52.
- ¹³² Statement of Treasury Under Secretary Gary Gensler before the House Banking Subcommittee on Capital Markets, Securities and Government Sponsored Enterprises, LS- 479, March 22, 2000; <https://www.treasury.gov/press-center/press-releases/Pages/ls479.aspx>
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