Memorandum

March 4, 1992

TO: Philip L. Conover
Deputy Executive Director

FROM: Beth L. Climo
General Counsel

SUBJECT: FHLBanks Providing Correspondent Services to Non-Members

In a letter dated November 1, 1991, the Credit Union National Association ("CUNA") requested an opinion on the criteria that an "eligible" institution that is not a FHLBank member must meet in order to contract for FHLBank non-credit correspondent services.

ISSUE:

Does the phrase "institutions eligible to make application to become members" in subsection 11(e)(2) of the Bank Act require a non-member to meet all of the membership eligibility criteria in subsections 4(a)(l) and (2) of the Bank Act to be qualified to receive FHLBank correspondent services, or is it sufficient that it simply be one of the types of institutions listed in subsection 4(a)(l) of the Bank Act as eligible to become a member of the Federal Home Loan Bank System ("FHLBank System")?

CONCLUSION:

Subsection 11(e) (2) can be interpreted in more than one way and contains language which explicitly grants the Federal Housing Finance Board ("Finance Board") discretion to define terms used in that subsection, including the "eligible to make application" language. One interpretation is that a non-member "eligible" institution must meet all the membership criteria in section 4 of the Bank Act in order to contract for FHLBank correspondent services. However, for reasons discussed herein, there appears to be stronger support for the interpretation that in order to be eligible to receive FHLBank correspondent services, a non-member must simply be one of the types of institutions listed in subsection 4(a)(l) of the Bank Act as eligible to become members of the FHLBank System. Thus, under this interpretation, a non-member need not satisfy all the membership eligibility requirements in subsections 4(a)(l) and (2) of the Bank Act. It appears that this is yet another instance in which the Finance Board must make a policy decision.

DISCUSSION:

I) BACKGROUND

In 1980, Congress expanded the scope of the FHLBanks' non-credit services through the enactment of the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA") See Pub, L. No. 96-221, 94 Stat. 132 (March 31, 1980). Specifically, section 311 of DIDMCA added subsection 11(e)(2) of the Bank Act to permit the FHLBanks to offer certain non-credit correspondent services to members and "institutions eligible to make application to become members pursuant to (section 4) of the Bank Act."[1] 12 U.S.C. § 1431(e)(2) (Supp.I 1989).

The types of institutions eligible to become members of the FHLBank System are specifically described in subsection 4(a) to include "any building and loan association, savings and loan association, cooperative bank, homestead association, insurance company, savings bank, or any insured depository institution.. . ." 12 U.S.C. § 1424(a). These eligible institutions must meet the membership criteria delineated in subsections O(a)(l) and (2) of

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1. Specifically, section 311 of DIDMCA added subsection 11(e)(2) of the Bank Act, which provides:

> The Board may, subject to such rules and regulations, including definitions of terms used in this paragraph, as the Board shall from time to time prescribe, authorize [FHLBanks) to be drawees of, and to engage in, or be agents or intermediaries for, or otherwise participate or assist in, the collection and settlement of (including presentment, clearing, and payment of, and remitting for), checks, drafts, or any other negotiable or nonnegotiable items or instruments of payment drawn on or issued by members of any (FHLBank] or by institutions which are eligible to make application to become members pursuant to section 1424 of this title, and to have such incidental powers as the Board shall find necessary for the exercise of any such authorization.

12 U.S.C. § 1431(e)(2) (Supp. I 1989) (Emphasis added).

the Bank Act in order to become members of the FHLBank System.'

At the time subsection 11(e)(2) was enacted, credit unions and commercial banks were not eligible to join the FHLBank System In fact, the only types of institutions that could have fit in the category of non-members "eligible to make application" were state chartered savings banks insured by the Federal Deposit Insurance Corporation, state insured thrifts, and insurance companies. Consequently, the "eligible to make application" language was not significant until the enactment of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 ("FIRREA"), Pub. L. No. 101-73 103 Stat. 183 (August 9, 1989), which added federally insured commercial banks and credit unions to the list of institutions eligible for membership.

FIRREA also added to the membership eligibility criteria the requirement that an insured depository institution have at least 10 percent of its total assets in residential mortgage loans (the "10 percent requirement"). 12 U.S.C. § 1424(a)(2)(A) (Supp. I 1989). Banks and credit unions must pass this asset test in order to become a member of a FHLBank. This was the provision added by FIRREA that was most instrumental in raising the question of whether "eligible to make application" means the same as meeting all membership criteria.

II) TWO ALTERNATIVE RESOLUTIONS

One position is that the "eligible to make application" language in subsection 11(e) (2) of the Bank Act must be read in conjunction with the membership criteria in section 4. Accordingly, for a federally insured non-member institution to buy

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2. Specifically, there are two separate sets of membership criteria which institutions must meet in order to become members of the FHLBank System. Under the first set of membership criteria, an applicant shall be eligible for FHLBank membership if it "(A) is duly organized under the laws of any State or of the United States; (B) is subject to inspection and regulation under the banking laws, or under similar laws, of the State or of the United States; and (C) makes such home mortgage loans as, in the judgment of the Board, are long-term loans.... a 12 U.S.C. § 1424(a)(l)(A-C) (Supp. I 1989).

   Under the second set of membership criteria, an insured depository institution may become a member of a FHLBank if "(A) the insured depository institution has at least 10 percent of its total assets in residential mortgage loans; (B) the insured depository institution's financial condition is such that advances may be safely made to such institution; and (C) the character of its management and its home-financing policy are consistent with sound and economical home financing." 12 U.S.C. § 1424(a)(2)(A-C) (Supp. I 1989).

collection and settlement services from a FHLBank, the institution would have to meet all the membership criteria in subsection 4(a)(l) and (2), including the 10 percent requirement.

An alternative interpretation is that such a non-member need not satisfy all of the membership eligibility criteria in section 4, namely the 10 percent requirement, but must simply be one of the types of institutions listed in subsection 4(a) as eligible to become a member of the FHLBank System.

In short, these two alternative interpretations raise the question of what, if any, of the membership eligibility criteria in subsections 4(a)(l) and (2) of the Bank Act must a non-member meet in order to contract for FHLBank correspondent services?

III) ANALYSIS

A) Plain Meaning

To ascertain whether a non-member must meet any of the membership eligibility criteria in order to contract for FHLBank correspondent services, the principles of statutory construction must be applied. The starting point of Statutory construction is the plain meaning of the text. Sutherland, Statutes and Statutory Construction, § 46.01 (4th ed. 1984).

The "eligible to make application" language is not defined anywhere in the Bank Act. However, subsection 11(e)(2) of the Bank Act contains explicit language which grants the Finance Board considerable discretion to define the terms used in that section, including the "eligible to make application" language.[3] The court6 will not disturb the Finance Board's interpretation unless it appears from the statute or its legislative history that its interpretation is not one that Congress would have intended. Chevron, U.S.A., Inc., v. Natural Resources Defense, 467 U.S. 046, 104 S.Ct. 2770, L. (1984); See also United States v. Shimer, 367 U.S. 374, 382,383, 81 S.Ct. 1554, 1560, 1561, s L.Ed. 2d 908 (1961). Accordingly, the Finance Board has considerable latitude in its interpretation of the phrase "eligible to make application" as used in subsection 11(e)(2), so long as it is consistent with the statute and its legislative purpose.

In determining how to interpret the phrase "eligible to

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3. Specifically, subsection 11(e)(2) provides in pertinent part:

> The Board may, subject to such rules and regulations, including definitions of terms used in this paragraph, as the Board shall from time to time prescribe.. ..

12 U.S.C. § 1431(e)(2) (Supp I 1989).

make application" in accordance with its statutory authority to define the phrase, similar language used in other sections of the Bank Act provides some guidance to the Finance Board. For example, subsections Q(a)(l) and(2), which list the membership eligibility criteria, use the language "eligible to become a member" and "may become a member" respectively when delineating the criteria an applicant must meet in order to be eligible for FHLBank membership, 12 U.S.C. § 1424(a)(l) & (2) (Supp. I 1989). Furthermore, section 6(f) provides that a FHLBank may ..b permit the disposal of stock to another member, or to an institution eligible to become a member, but only to enable such an institution to become a member." 12 U.S.C. § 1426(f) (supp. I. 1989).

It is an elementary rule of statutory construction that effect must be given, if possible, to every word, clause and sentence of a statute. Sutherland, supra, § 46.06 at 104. There is a clear distinction between "eligible to make application" in subsection 11(e)(2) and "eligible to become a member." The "eligible to make application" language suggests some lesser standard than actually being eligible to become a member. Arguably, if Congress intended a non-member to meet all the criteria for membership in order to contract for FHLBank correspondent services, it would have used language to that effect.

B) Legislative History

The legislative history of subsection 11(e)(2) can be interpreted to support the conclusion that a non-member need not satisfy the membership eligibility criteria in section 4, but must simply be one of the types of institutions listed in subsection 4(a) as eligible to become a member of the FHLBank System. As mentioned above, subsection 11(e)(2) was added to the Bank Act by the DIDMCA Conference Committee. The Conference Committee's sole reference to "institutions eligible to make application" as incorporated into subsection 11(e)(2) is as follows:

> The conferees adopted a provision to permit Federal Home Loan Ranks to process NOW account drafts and other instruments issued by their members or those eligible for membership.

Joint Explanatory Statement of Congress, H.R. Rep. 842, 96th Cong., 2nd Sess. 74 (1980) ("Conference Report").

Consideration of this amendment to the Bank Act as part of DIDMCA changes in 1980, in tandem with DlDMCA's changes to other analogous provisions, suggests that Congress knowingly and intentionally used the phrase "eligible to make application to become members" rather than "eligible to become members." For example, in addition to granting the FHLBanks check processing and clearing powers, Congress also bestowed similar authority in section 312 of the DIDMCA to the National Credit Union

Administration's ("NCUA's)" Central Liquidation Facility to process checks and drafts for its member credit unions. Although sections 311 and 312 follow each other in the DIDMCA and confer similar powers, there is one significant difference between the two sections. Section 311 authorizes the FHLBanks to offer correspondent services to members and "institutions eligible to make application to become members." In contrast, section 312 confers on the NCUA's Central Liquidation Facility the authority to offer correspondent services to credit unions and other entities that are "eligible to become a member of the Central Liquidation Facility.. .." This is the only substantive difference between the two statutory provisions. To define these phrases exactly the same ignores the "to make application" language contained in section 311 and is contrary to the rule of statutory construction that "effect must be given, if possible, to every word, clause and sentence of a statute." Sutherland, supra § 46.06 at 104; see also United States v. Menasche, 340 U.S. 528, 538-39 (19SS);Tabor v. Ulloa, 323 F.2d 823, 824 (9th Cir. 1963) (A legislature is presumed to have used no superfluous words,)

Further, the "eligible to make application" language is used in another context in the DIDMCA. Section 103 of the DIDMCA amended section 19(b) of the Federal Reserve Act and thereby expanded the types of institutions which are required to hold reserves against deposits. Reserves must be maintained against deposits held by financial institutions that meet the Federal Reserve Act's definition of "depository institution." Section 103 of the DIDMCA amended section 19(b) of the Federal Reserve Act to define the term "depository institution" as any insured bank, mutual savings bank, savings bank, credit union, savings and loan association, or any institution "eligible to make application" to become any of the foregoing. 94 Stat. 133, current version at 12 U.S.C. § 461. The DIDMCA Conference Report states that the purpose of this language is to make reserve requirements applicable to all depository institutions. Conference Report, at 69.

On several occasions, the Board of Governors of the Federal Reserve System ("Federal Reserve Board") has interpreted the "eligible to make application" language to apply the reserve requirements very broadly, to any institution that is eligible to make application for deposit insurance, whether or not the institution meets the requirements for deposit insurance. See Board Ruling and Staff Opinions Interpreting Regulation D, — Opinions 2-310, 2-310.1, 2-301.13, and 2-310.14, 3 Fed. Banking L. Rep. (CCH) ¶ 30,499G. In each case, the analysis is focused on whether the institution is permitted under its chartering authority to apply for deposit insurance. Although several conditions must be met in order to actually obtain deposit insurance (e.g., valid incorporation, an acceptable management staff, sound financial condition), the Federal Reserve Board does not consider them when determining whether an institution is eligible to make application for deposit insurance and, thus, subject to reserve requirements under section 19(b).

In short, the use of the "eligible to make application" language in both sections 103 (for purposes of reserve requirements) and 311 (for purposes of FHLBank correspondent services) and the lack of similar language in section 312 (for purposes of the Central Liquidation Facility's correspondent services) supports the conclusion that Congress intentionally used the language in order that FHLBank correspondent services would be available to all institutions listed in subsection 4(a) of the Bank Act regardless of whether they satisfied all the requirements to actually obtain FHLBank membership.

III) CONCLUSION

Subsection 11(e)(2) of the Bank Act explicitly grants the Finance Board discretion to define terms used in that subsection, including the phrase "eligible to make application." Although the "eligible to make application" language may be interpreted in more than one way, the statute and its legislative history clearly can be read to support the interpretation that in order to be eligible to receive FHLBank correspondent services, a non-member must simply be one of the types of institutions listed in subsection Q(a)(l) of the Bank Act as eligible to become members of the FHLBank System. Further, this interpretation conforms with the Federal Reserve Board's interpretation of similar language used in other sections of the DIDMCA. Therefore, the Finance Board would be operating within a reasonable interpretation of the Bank Act and its legislative history if it concluded that the "eligible to make application" language simply requires a non-member institution to be one of the types of institutions listed in subsection 4(a)(l) of the Bank Act as eligible to become members of the FHLBank System.

Beth L. Climo
General Counsel