Federal Housing Finance Board

March 30, 1993

MEMORANDUM

TO: Daniel F. Evans, Jr., Chairman
Henry G. Cisneros
Marilyn R. Seymann
Lawrence U. Costiglio
William C. Perkins

FROM: Beth L. Climo BLC
General Counsel and Director
Office of Legal & External Affairs

SUBJECT: Policy and Practical Implications of FHLB-New York Position on Non-QTL Issue

We received an analysis from the Federal Home Loan Bank (FHLBank) of New York (FHLB-New York), dated January 21, 1993, which presents the case that the non-qualified thrift lender (non-QTL) provisions of the Federal Home Loan Bank Act (Bank Act) do not apply to insurance companies since these provisions, in fact, may have applicability only to savings associations. We also received an opinion letter dated March 16, 1993, from the firm of Krieg, DeVault, Alexander & Capehart (Krieg, DeVault), representing seven FHLBanks, which reaches a similar conclusion. For purposes of this memorandum, references to FHLBank-New York also refer to Krieg, DeVault.

It is important to appreciate the policy and practical implications of the legal position set forth by the FHLB-New York. Adoption of the FHLB-New York position would result in a fundamental change in the legal assumptions under which the Finance Board and the FHLBank System have operated since the enactment of the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA). These assumptions have been applied not only in the context of the proposed advances rulemaking, but also in the day-to-day operations of all of the FHLBanks and on all matters involving the non-QTL provisions, including the Finance Board's and the FHLBank System's responses to various legislative initiatives.

Background

First, recall that there are three principal non-QTL provisions in the Bank Act:

- Non-QTL members are subject to a special stock requirement. The Bank Act requires each non-QTL member to hold stock equal to five percent of its outstanding advances divided by its ATIP. Thus, the lower the percentage of the non-QTL member's portfolio that is invested in home mortgage assets, the more FHLBank stock the non-QTL member must hold in order to borrow.

- Non-QTL members may receive advances only for "housing finance."

- The Bank System may not have more than thirty percent of its total advances outstanding to non-QTL members. 12 U.S.C. § 1430(e)

Discussion

The following describes briefly the policy/practical results of adopting the FHLB-New York's legal position on these three non-QTL provisions. A legal analysis by the OL&EA-Legal Division of the FHLB-New York's position is contained in the attached memorandum.

1. Insurance Companies Alone Cannot Be Carved Out

To reach the result requested by the FHLB-New York, it is necessary to conclude that the Bank Act's non-QTL provisions (listed above) only apply to institutions that are required by law to meet the Office of Thrift Supervision's (OTS) separate QTL requirements contained in the Home Owners' Loan Act (HOLA). In other words, the FHLB-New York analysis is premised on the legal argument that these provisions apply only to savings associations, but not to other members of the FHLBank System. Thus, in addition to insurance companies, all commercial bank and credit union members of the FHLBank System would be exempt from the Bank Act's non-QTL provisions.

2. Policy/Practical Ramifications of the Result Requested by the FHLB-New York

Three important ramifications of the legal analysis that reaches the result requested by the FHLB-New York are:

- The non-QTL provisions of current law would have almost no applicability and, thus, virtually no effect. Subject to a limited exception within the discretion of the OTS, HOLA separately precludes non-QTL savings associations from receiving advances from the FHLBank System. Accordingly, if the Bank Act's non-QTL provisions (listed above) were interpreted to apply only to non-QTL savings associations, those provisions would be almost entirely redundant to the HOLA restrictions. In other words, if the Bank Act's non-QTL

provisions are applied only to savings associations and not to other System members, the non-QTL provisions would apply only in extremely limited circumstances.

- The result would be directly contrary to the public positions taken by the Finance Board and the FHLBank System, including its position on the Baker-Neal bill. One of the major components of the Baker-Neal bill has been the repeal of these non-QTL provisions -- which have been represented as creating "unequal" membership rules. If, in fact, the non-QTL provisions do not apply to insurance companies, banks and credit unions, and only apply to savings associations in rare instances, there is no need for legislative change to these non-QTL provisions or for Baker-Neal's "equal access to membership" provisions. Thus, if we accept the FHLB-New York position, we could be accused of doing by regulation what we have not been able to accomplish through legislation.

- There would have been no need to change the statutory non-QTL thirty percent cap. Congress recently changed the limit on advances to non-QTL members so that no more than thirty percent of the System's total advances can be made to non-QTL members, rather than no more than thirty percent of each FHLBank's total advances. Congress changed this non-QTL thirty percent cap to a System-wide limit based on Finance Board and FHLBank representations that the thirty percent cap would soon become binding for some of the FHLBanks. The FHLB-New York would now have us say that this thirty percent cap has virtually no effect, since advances to only a very limited number of savings associations (five currently) would be in the numerator of the calculation, with all advances to all members making up the denominator. If the FHLB-New York is correct and the non-QTL provisions apply only to non-QTL savings associations, then no FHLBank was ever anywhere near hitting the thirty percent cap and it was unnecessary for Congress to change the thirty percent limit from an individual FHLBank cap to a System-wide cap.

3. Possibility of Judicial Challenge

There are competing interest groups which will have strong views on the non-QTL interpretation issue, which suggests the possibility of a challenge to agency rulemaking on the applicability of the non-QTL provisions. For this reason, the Board needs to be confident that the position it takes on the non-QTL provisions is legally defensible. As explained in detail in the attached legal memorandum, the courts look askance at rulemakings which interpret statutes contrary to their plain meaning. The advances rulemaking will be on much sounder footing if it is based on an interpretation that the phrase "member that is not a [QTL]" applies to all members, rather than just to savings association members.

Attachment