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July 15, 2024

Sandra L. Thompson

Director

Federal Housing Finance Agency

400 7th Street, SW

Washington, DC 20024

RE: [FHLBank Core Mission Activities and Mission Achievement RFI](https://www.fhfa.gov/sites/default/files/2024-05/FHLBank-Mission-RFI-2024.pdf)

Dear Director Thompson and FHFA Staff:

It has been almost two years since the Federal Housing Finance Agency launched its comprehensive review of the Federal Home Loan Banks. In those two years, the nation’s housing crisis has grown worse with soaring home and rent costs and a dwindling housing supply. It is remarkable that throughout this review process it is only the Federal Home Loan Banks themselves that claim to be doing an adequate job in addressing our housing crisis.

The review was [announced](https://www.fhfa.gov/news/news-release/fhfa-announces-comprehensive-review-of-the-federal-home-loan-bank-system) on August 31, 2022 after articles I wrote along with former FDIC chairman William Isaac were published pointing out the tremendous potential of the FHLB System and how that system was failing to meet its most basic obligations. Those articles are attached here.

In our first article published by the *American Banker* on December 1, 2021, we said that the very mission of the Federal Home Loan Banks ought to be reexamined. As we observed then, “The current mission has been narrowly construed by the FHFA and even more narrowly construed by each of the banks. Yet the demands of today’s economy have raced far beyond those of the 1930s.”

It is appropriate therefore that the Agency reach out to all stakeholders seeking guidance on the appropriate mission for the Federal Home Loan Banks. I appreciate that opportunity and do so here. I note, however that, during the pendency of this review, the Agency’s task has been made more challenging by rulings of the United States Supreme Court.

I refer, of course, to the “major question” doctrine created by the Court’s ruling in *EPA v. West Virginia* limiting agencies’ authority to act on matters of vast economic and political significance where Congress has not clearly empowered the agency with authority over the issue; and to the Court’s recent ruling in *Loper Bright Enterprises v. Raimondo*, limiting a reviewing court’s deference to the expertise of the cognate agency as was the standard practice under the *Chevron* doctrine previously articulated by the Court.

These rulings, taken together with a recalcitrant and well-funded industry, might caution the Agency to act timidly in reforming the Federal Home Loan Banks. However, as I urged the Agency and its staff in [the first listening session](https://www.fhfa.gov/news/videos/fhlbank-system-at-100-public-listening-session-day-1) held on September 29, 2022: “Of course, you will determine what *must* be done. But the border of your legal authority need not be the border of your imagination. I urge you to explore what *can* be done!

Below I address two significant issues which, if acted upon, could unleash the enormous power of the Federal Home Loan Banks toward addressing the current national housing crisis. These are: first, revising the organization certificates of each of the eleven banks to state unambiguously that their mission is to provide liquidity to members *for* housing and community development; and, second, revising the statutory formula for each firm’s baseline contribution to affordable housing linking it to the total taxpayer subsidy received by the FHLBs. Both changes would withstand legal challenge.

*Editorial Comment: Noted economist and Federal Reserve historian, Allan Meltzer once labeled the Federal Home Loan Banks as the “Flubs”. The term is widely used. Thus far, I have resisted the term because it is pejorative. It is, however, more accurate than their formal title because these firms: a) make no Home Loans, and b) are not Banks in any customary use of that word. They are Federal because they are completely dependent on federal taxpayer support. However, the FHLBs publicly, emphatically, and wrongly deny the existence of any taxpayer support. Moreover, the definition of a flub as a “*[*blunder*](https://www.merriam-webster.com/dictionary/flub)*” aptly describes how the FHLBs have carried out their perceived mission. Therefore, I will use the word “Flubs” in the body of this letter when referring to this GSE.*

**Change the Business Model**

For many months, I have been engaged in a dialogue with the leadership of one of the Flubs around the idea of modeling the Flubs after “public benefit corporations.” Public benefit corporations are those for-profit enterprises that have built into their purpose not simply making money for their owners but achieving some other public good.

The leaders I have been collaborating with are receptive to the proposition of using the benefit corporation as a business model with the Flubs. They have vetted it with their Flub’s board of director, its executive committee, and its legal department. I have discussed it informally with the Agency’s staff. The concept was originally discussed in an [*American Banker* article](https://www.americanbanker.com/news/should-the-federal-home-loan-banks-become-public-benefit-corporations) on August 28, 2023.

I strongly agree with the statement in the RFI (page7) that support for housing and community development needs to go well beyond the Flubs’ targeted programs (AHP, CIP, and CICA). It clearly does not now and has not for decades.

According to the RFI, such support needs to be “… central to the FHLBanks’ day-to-day business with members and housing associates.” It is only by imprinting housing and community development on the DNA of each Flub’s business model can this mission be achieved.

The idea is disarmingly simple.

Despite the word “Bank” in their names, Flubs do not have charters as do normal banks. Rather, each Flub has what is called an Organization Certificate. All eleven documents appear to be similar dating back to the Flubs’ founding in 1932[[1]](#footnote-1). They have been amended slightly over the years to reflect the Flubs’ movements to different cities and the imposition of different regulators by Congress but, for the most part, they remain the same.

When it comes to stating what the Flub is authorized to do, the certificates are obscure. For example, the Flub of Atalanta certificate states: “The Bank shall engage in the business authorized by the Federal Home Loan Bank Act … and it shall exercise such powers as are permitted or prescribed by said Act, subject to the supervision of the Director.”

That’s it! No mention anywhere in the document of advances, housing or community development.

And why should there be? At the time they were created by Congress, the Flubs’ members were mostly savings and loan associations whose only business was making short-term (by today’s standards) mortgages. Of course they were going to promote housing. Their owners were savings and loans, what else would they do? No need to belabor the point in an Organization Certificate.

Fast forward to 2024 and most Flub members are generic banks and most of them do not even make housing loans. Savings and loans are part of American lore but not part of its economy today. Yet the Flubs soldier on . . . farming their taxpayer subsidy using founding documents from a bygone era that pay little heed to the housing crisis that rages around them.

Fortunately, my correspondents at the FHLB of X have a more enlightened view. They recognize that the Flubs have a three-part mission: liquidity for members, housing and community development.

In this regard, they are at odds with the lobbyist who represents all eleven Flubs. [He advocates](https://www.americanbanker.com/podcast/the-poignant-american-drama-of-the-home-loan-bank-system) that the Flubs’ whole mission is to provide cheap taxpayer funding for their members and, if there’s anything left over, give 10% to affordable housing. He states: “Let's keep in mind, the whole purpose of the Home Loan Bank System is to provide liquidity to our members in all market environments.”

Putting aside the lobbyist’s comments as hyperbolic advocacy[[2]](#footnote-2), most Flub leaders would acknowledge that the mission of this entire $1.3 trillion system is liquidity for members in the support of housing and community development. Certainly, the Flub leaders that I have been corresponding with recognize this.

How would being a benefit corporation impact the Flubs?

**Reputation**: Being a benefit corporation carries with it significant cache in terms of the perception of the public, customers, prospective employees, etc.

**Delivering the Goods**: Along with that cache comes responsibility. Boards and managements have to deliver the goods by balancing the financial rewards of shareholders with the public benefits (housing and community development) articulated in the Organization Certificate.

**Accountability**: A trusted independent third party is charged with evaluating whether the firm has lived up to its claims to be balancing the interests of its shareholders and the public in a fair way. Failing to do so risks the loss of benefit corporation status (See “Reputation” above).

How can this be brought about?

**Collective Action**: The Flubs themselves can recognize, as most already do, that their mission is trifold (liquidity, housing and community development).

**Organization Certificate**: The boards of directors of each Flub can approve an amendment to their Organization Certificate incorporating the not-so-new mission. The Organization Certificate is then submitted to the FHFA for her approval.

**Agreement**: The Flubs agree to a biennial audit by an independent third party to assess whether they have lived up to their commitments as benefit corporations.

Of course, this approach raises many questions: What are the measurements for balancing competing interests? What are the penalties for losing status as a benefit corporation? What entity is to conduct the audit? All of these need to be addressed.

One thing is certain . . . given the Flubs scant contribution to the public good now, there is little to lose and much to gain. And, after all, shouldn’t an enterprise, heavily subsidized by the taxpayers (see below), be held to a higher standard?

**Affordable Housing**

In 1989 and over the objection of the Flubs, Congress amended the Federl Home Loan Bank Act by adding a requirement that the Flubs devote a *de minimus* 10% of their net income to affordable housing. This modest requirement was in exchange for opening the floodgates by admitting as members all commercial banks. Today most Flub members are commercial banks and less than half of all members are active in the housing market.

Yet, every week since that time, the Flubs have waged a public relations campaign issuing a barrage of self-serving press releases. These anodyne statements are unfailingly incomplete and misleading.

They read, “Flub of X today announced it has contributed Y dollars to affordable housing project Z.” That is followed by self-congratulatory language about project Z and an equally effusive description of Flub X. Local media outlets regurgitate the Flubs’ propaganda word-for-word for their readers.

This steady drumbeat of propaganda is incomplete because not once in this span of decades has one of the Flubs bothered to mention the actual source of the funds they are giving away. Hint: It is the taxpayers’ money. The drumbeat is misleading because it is purposefully designed to create the favorable false impression in the mind of the public that the Flubs are eleemosynary institutions, in business for the public good. They most certainly are not.

Recently, the [Congressional Budget Office](https://www.cbo.gov/publication/60064) did us the favor of calculating the amount of the taxpayer subsidy that flows to the Flubs. According to [CBO’s methodology](https://www.americanbanker.com/opinion/cbo-called-out-the-federal-home-loan-banks-its-now-up-to-congress), the eleven FHLBs receive an annual taxpayer subsidy of almost $11 billion. That is the source of the funds for the Flubs munificence and for which the Flubs take a deep bow and announce with such fanfare. There is nary a reference to the taxpayers’ role.

In round numbers the taxpayer subsidy works out to about $1 billion per Flub, per year.

Now, consider that the average Flub contribution to affordable housing last year was approximately $35 million. In other words, for every $1 billion in taxpayer subsidy, each Flub manages to contribute just 3.5% of it to the public good.

Where does the other 96.5% go? CBO euphemistically calls it a “pass through” to the Flubs. CEOs skim off millions off the taxpayer subsidy for themselves ($2.9 million per CEO) and the rest goes to the member banks of each Flub in the form of below market, taxpayer supported, funding and rich dividends from the Flubs.

By any measure, these subsidies should be considered “transfer payments”, a term usually associated with social programs such as welfare and student loans. According to [Investopedia](https://www.investopedia.com/terms/t/transferpayment.asp): “A transfer payment is a one-way payment to a person or organization which has given or exchanged no goods or services for it.” An FHFA official at the listening session held on September 29, 2022, was correct when he candidly referred to this arrangement as “corporate welfare.”

Since 1944, Hallmark has been selling its greeting cards with the slogan: “When you care enough to send the very best." The Flubs appear to have adopted a version of this as their business model: “We care enough to *do the very least*.”

The reason the Flubs get away with their niggardly contributions to affordable housing is that their legal responsibilities are baked into the statute. By law, each Flub must devote 10% of its net income to affordable housing. The law is flawed. As Senators Cortez Masto and Warren and Congressman Torres have indicated in their letter of even date, net income can be, and it is, easily manipulated by the Flubs.

For example, the Flubs reduce their net income by paying their executives *more* and by charging their members *less* for advances. The conflict of interest between the Flubs and their executives and members, on the one hand, and affordable housing on the other is blatant. It can be remedied by amending the faulty statute that dates to 1989.

Thus far, reform efforts have focused on increasing the numerator, 10%, rather than the denominator, net income. In its report, FHFA calls for increasing the numerator to at least 20%.

This is a worthy aspiration; however, even if adopted by Congress, the Flubs would easily do an end-around the new statute by paying themselves even more than they are already and by charging less for their members to borrow.

The solution is to use the tools that CBO has given us and change the denominator of the statutory formula from net income to the actual taxpayer subsidy bestowed on the FHLBs. And, yes, the numerator needs to be raised as well to reflect that the Flubs are a public/private enterprise.

# # #

Respectfully,



Cornelius Hurley

Attachments

ATTACHMENT A



[https://www.americanbanker.com/opinion/reimagining-the-federal-home-loan-bank-systemTop](https://www.americanbanker.com/opinion/reimagining-the-federal-home-loan-bank-system) of Form

[**POLITICS AND POLICY**](https://www.americanbanker.com/tag/politics-and-policy)

**BankThink**

**Reimagining the Federal Home Loan Bank System**

**By** [**Cornelius Hurley**](https://www.americanbanker.com/author/cornelius-hurley)[**William M. Isaac**](https://www.americanbanker.com/author/william-m-isaac) **December 01, 2021, 10:57 a.m. EST6 Min Read**

A vital cog of the United States’ financial system is at risk. For 89 years, the Federal Home Loan Bank System has been a reliable source of liquidity for most of the nation’s banks, credit unions and insurance companies. Without meaningful change, this remarkable public-private partnership is nearing the end of its relevance.

Created in 1932 during the waning days of the Hoover administration, this intricate structure of 11 — 12 at the time — banks scattered across the U.S. has been a bulwark of our financial system. Member-owned but federally supported, these 11 banks have provided backup liquidity to their members through secured advances. The system is able to fund itself through debt obligations it issues that carry reduced risk premiums due to the implied guarantee of the federal government.

The Home Loan banks that make up the system are cooperatively owned by the financial institutions in their districts. This is in stark contrast with their distant government-sponsored-enterprise cousins, Fannie Mae and Freddie Mac, which were owned by profit seeking shareholders and are now in conservatorship. Each Federal Home Loan bank devotes a significant portion of its net income to affordable housing and to economic development in its district.

A graph of blue bars

Description automatically generated with medium confidence

Through the Great Depression, numerous recessions, the Y2K scare, the savings and loan debacle, and other stresses in the financial markets, the system has been a stable source of funding for financial intermediaries. Long before the Federal Reserve rolled out its “urgent and exigent” instruments in the 2008 financial crisis, the system offered an oasis of funding when few others were in sight.

Now, this beacon of the financial system is itself at risk — not from any missteps of its own but rather from the pandemic-driven actions of the same federal government that created it. The Federal Reserve has so flooded the financial system with liquidity that the member owners of the system’s banks no longer need to borrow from it, thus calling into question its very reason for existence.

Advances to member institutions, the lifeblood of the system, currently stand at $350 billion. This contrasts with $658 billion two years ago. The system’s assets, over $1.2 trillion during the financial crisis, now stand at about half of that. Not a blip, this precipitous decline in advances and assets is expected to persist in coming years. Moreover, even when interest rates normalize, the system will still face enormous challenges from its members having available to them other competitive sources of funding.

It would be easy in light of its declining use and relevance to consign the system to the fate of, say, the Civil Aeronautics Board and other such agencies of government that outlived their purposes. The Home Loan bank system, however, is different. As one [important study](https://www.sunypress.edu/pdf/62072.pdf) observed, the 11 Home Loan banks “make a difference in what gets done in the world.” Indeed, they do. From affordable housing to job creation, to economic development, to preserving community banks, the system and its banks have made a difference.

The question is: Will the Home Loan banks be relevant going forward?

Most would like to see government and quasi-governmental institutions be as lean and efficient as possible. Focusing this efficiency lens on the system at this point in time could easily lead to the conclusion that the system ought to be disbanded or that the 11 banks should be consolidated. Before it is consigned to the bureaucratic dust heap, however, a closer look ought to be focused on its unique business model and how, with modest modifications, it might be repurposed to meet the challenges of the modern era.

The system blends the advantages of federal government support with local on-the-ground insight and control through its semi-autonomous Federal Home Loan banks. Each bank is overseen closely by the Federal Housing Finance Agency. The board of each bank consists of member directors and independent directors from its region. All banks are jointly and severally liable for the obligations of their peer banks, adding a level of self-discipline that is reinforcing. By law and by culture, the system is mission-driven — perhaps even to a fault.

Congress, having created the system, ought to closely reexamine its potential social and economic utility. Such an analysis will likely result in the conclusion that the system’s business model, although outdated, is uniquely suited to today’s financial needs and challenges.

In this important endeavor, [recent remarks](https://www.occ.gov/news-issuances/speeches/2021/pub-speech-2021-115.pdf) by acting Comptroller of the Currency Michael Hsu are instructive. He addressed directly the problem facing banks when challenged by fintechs invading their regulatory perimeter. Rather than defaulting to the rote position of expanding the regulatory perimeter of banks to include fintechs, he challenged banks, fintechs and regulators alike to reimagine the regulatory perimeter for the modern era, an approach he described as “leveling up.”

Should Congress choose this more enlightened path of leveling-up the Federal Home Loan Bank System, the framework for doing so is relatively clear. Adjustments needed to restore the system’s current relevance fall into three categories. Those are: mission, membership and collateral. As a guide in examining each category, to paraphrase the late Sen. Robert Kennedy, the most productive inquiry is not “Why?” but “Why not?”

With regard to the system’s mission, why not expand it beyond housing finance to include financing initiatives in the arenas of climate change, infrastructure development and economic equity? The current mission has been narrowly construed by the FHFA and even more narrowly construed by each of the banks. Yet the demands of today’s economy have raced far beyond those of the 1930s.

Regarding its membership, why not open membership eligibility to lenders to the country’s small businesses that create two thirds of all new jobs, fintechs that promote financial inclusion, and nonbanks that originate most of today’s home mortgages? The leveled-up perimeter will include many of these and, besides, banks and credit unions are a dwindling part of the financial system.

As for collateral, why not expand the eligible collateral for system advances to include the many asset classes, in addition to mortgages, that support the new system’s more modern mission? Housing is vital, but so too are roads, bridges, renewable energy, small businesses and sustainable farms. Why not expand the scope of collateral each system bank can accept as collateral for their advances?

Here is the challenge.

The system enjoys an enormous funding advantage. However, change is unlikely to come from within its ranks. Member institutions tend to view their modest ownership interests in their respective Federal Home Loan banks as a claim on each bank’s capital. Members generally fail to acknowledge that the capital of each bank, including over $22 billion in retained earnings, has been accumulated over nine decades largely on the strength of the implied federal guarantee of the system’s debt obligations.

The leveling up process should lead each enlightened member-owner of the Federal Home Loan banks to recognize that the enhanced value of its investment in a reimagined and dynamic system far outweighs any short-term dilution of its current investment in the banks, which are in a state of secular decline. The system will survive through growth, not through one-time expense reductions.

So, change will need to come from enlightened external sources. The Biden administration’s opportunity to nominate a new, forward-leaning leader (including the nomination of the current acting director) to head up the FHFA is one such source. So too are the many and varied players who could benefit from access to a new and improved system. Nowhere is it written that leveling up must be a painful exercise. It can also open many doors of opportunity.

*The views expressed are solely those of the authors, and do not necessarily represent the views of any organization with which the authors have been or are now affiliated.*

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ATTACHMENT B

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January 31, 2022

<https://www.americanbanker.com/opinion/its-time-to-rethink-the-mission-of-the-federal-home-loan-bank-system>

AN OPEN LETTER

To

SANDRA L. THOMPSON

FEDERAL HOUSING FINANCE AGENCY

Regarding

THE FUTURE OF THE FEDERAL HOME LOAN BANK SYSTEM

Ms. Sandra L. Thompson

Director Designate

Federal Housing Finance Agency

Washington, DC

RE: **The Federal Home Loan Bank System**

Dear Ms. Thompson:

Please add our voices to the chorus of those cheering President Biden’s nomination of you as Director of the FHFA. Your extensive record of achievement at the FHFA and the FDIC, indications of senatorial support for your nomination, and the skill with which you handled your confirmation hearing on January 13, leave little doubt that the U.S. Senate will take favorable action on your nomination in the near future.

At your confirmation hearing last month, you took note of the “relatively low earnings” of the eleven banks that constitute the Federal Home Loan Bank System. As we pointed out in a [recent article](https://www.americanbanker.com/opinion/reimagining-the-federal-home-loan-bank-system) in the *American Banker*, not only are earnings of the System’s banks low but their advances have declined precipitously in recent years along with their future prospects.

The System faces at least two strategic challenges. First, it finds itself in the unenviable position of fighting the Fed as the latter has flooded the banking system with liquidity. Second, the System’s member/owners consist exclusively of depository institutions and insurance companies at a time when the vast majority of mortgages are being originated by nonbanks that are excluded by law from the System.

The System’s secular decline has prompted some to call for consolidation of the eleven regional banks. Others question the very relevance of a System designed to address the challenges of the Great Depression to a modern financial system whose perimeter is being reshaped daily by the forces of competition and financial technology.

It is understandable that in the early days of your tenure as Director of the FHFA you will focus on the future role and structure of the two most prominent GSEs, Fannie Mae and Freddie Mac. We strongly urge, however, that even in the early days you initiate a strategic review of “the other GSE”, the Federal Home Loan Bank System.

This review can begin by asking these two key questions: 1) Currently, and for the foreseeable future, does the Federal Home Loan Bank system serve a useful purpose? and 2) Should the System be repurposed to meet the financial needs of the modern era? The answers to these questions are, in our opinion, respectively and emphatically, “No” and “Yes”.

The FHL Banks occupy a prominent position in the housing industrial complex, that firmament of lobbyists, lawyers and assorted actors referred to as the “housers” by Joe Nocera and Bethany McLean in their book about the recession of 2008-09, *All the Devils Are Here*. For almost ninety years, they have provided backup liquidity to the banks, credit unions and insurance companies that are the owners of the eleven banks from New York to San Francisco. Moreover, the System has an admirable though understated role in funding affordable housing.

There are many financial deserts, however, for which the oasis of FHL Bank liquidity could provide the same public good as it did to housing in the 1930s. Infrastructure, climate change, small business, economic inequality and serving the unbanked are just a few of the sectors currently outside of the regulatory perimeter of the FHL Banks. It need not be so.

Unleashing the full potential of the System does not mean opening the spigots of federal dollars for every special interest that comes along. The FHL Banks are experienced in the use of haircuts, credit enhancements and sound underwriting to ensure that the modernized mission of the system is caried out in a safe and sound manner under the watchful eye of the FHFA. It is this culture of prudent lending that allows the FHL Banks to boast that not a single dollar has been lost on advances by any of its banks.

To assist you in exploring the possibilities inherent in a reimagined System, we urge that you appoint an advisory committee consistent with the standards of the [Federal Advisory Committee Act](chrome-extension://efaidnbmnnnibpcajpcglclefindmkaj/viewer.html?pdfurl=https%3A%2F%2Fwww.gsa.gov%2Fcdnstatic%2FFACA-Statute-2013.pdf). From your experience at the FDIC, you realize how effective such committees can be to an agency’s executive management.

Members of the committee would be appointed by you and would represent current System stakeholders consistent with the Act. Crucially important, however, would be the appointment of industry leaders and academics who could contribute their creative talents in exploring the *potential stakeholders* of a more modern and relevant System…a System in touch with current demands for liquidity.

To inform the work of the advisory committee we also urge that you issue a call-for-papers on the topic of reimagining the System. In this regard, Acting Comptroller of the Currency Michael Hsu’s recent [call for papers](https://www.ots.treas.gov/news-issuances/news-releases/2021/nr-occ-2021-138.html) to address climate change and banking regulation may be instructive. We anticipate that consumer groups, specialty lenders, NGOs, academics and many others will be eager to offer up their ideas about how a System currently in decline can be reinvigorated to serve today’s needs.

Of course, we stand ready to assist you in any way we can in this effort.

With every good wish,

Cornelius Hurley

William M. Isaac

\*Prof. Hurley was an independent director of the Federal Home Loan Bank of Boston (2007 to 2021). Mr. Isaac, former Chairman of the FDIC (1978 through 1985) and former Chairman of Fifth Third Bancorp, is Chairman of the Secura/Isaac Group.

1. Based on a review of several Organization Certificates available on Flub websites. Not all are available. [↑](#footnote-ref-1)
2. Bear in mind that the lobbyist’s compensation and the CEO compensation of the eleven Flubs that averages $2.9 million per CEO exceed $35 million. Every dollar spent on lobbyists and CEO compensation lowers the amount available for affordable housing by 10%. [↑](#footnote-ref-2)