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Subject: ***FHFA Listening Tour for the Federal Home Loan Banks***

I am a professor of finance, banking and real estate with the George Washington University's School of Business. In addition to my academic duties, I have about 50 years of experience with the Federal Home Loan Bank System. I have worked as an analyst in examinations and supervision with the FHLBB and then consulted with the agency and the Office of Thrift Supervision for 40 years. I was appointed as the first private citizen director with the Office of Finance and have served as an independent director with the Federal Home Loan Bank of Atlanta for 16 years to include service as vice chair of the board and chair of the finance, audit and enterprise risk committees. I started my career as a commercial business lender with the National Bank of Detroit and later worked with and consulted with the FDIC for 40 years. Finally, I served as a director with the Federal Reserve Bank of Richmond and chaired the Baltimore Branch. I have written scores of academic and professional articles related to banking and bank regulation. I have a broad and deep knowledge of the Federal Home Loan Bank System and their members.

The 11 Banks provide exceptional service to their communities by lending to large and small banks, credit unions and insurance companies. Just as many consumers prefer to bank with a local community bank, many members like to deal with a regional Bank. The Banks support affordable housing programs but could and should provide more financial funding for low-income families and distressed communities. Each dollar of AHP translates into a double-digit multiplier in the affected communities and supports the country's growth.

- **Advance Expansion and the *Great Recession***: The System is easily able to support growth and contraction of advances given the innovative relationship between activity-based stock and advance demand. Quick growth invariably adversely affects the capital ratios of commercial banks but the FHLBanks grow capital with growth. The System was a source of great liquidity during the *Great Recession* when confidence in banks was tested by the failure of almost 500 institutions and the performance of the Federal Reserve prior to the housing debacle when most, but not all, officials refused to observe the risk developing in the origination of high-risk mortgage loans to credit-impaired mortgagors and the subsequent repackaging into high-risk (despite "AAA/Aaa" credit rating) PLMBS and CMO securities. The chairman of the Federal Reserve grossly underestimated the consequence to the economy and the banking industry indicated, "We believe the effects of the troubles in the sub-prime sector on the broader housing market will likely be limited." Regulators make mistakes as well as bankers.

- **Contraction and the Covid-Pandemic**: It is easy to question the relevance of the System given the sharp decline in advances during the Covid-pandemic starting in 2020. The Banks incurred the unintended consequence of massive fiscal support provided by Congress and the Department of Treasury. *The Coronavirus Relief, and Economic Security Act* (CARES Act) overwhelmingly passed by Congress and signed into law by the president March 27, 2020 responded to the loss of personal income and business sales due to Covid-19. The CARES Act not only provided $2.2 trillion of federal support to businesses and consumers affected by the devastating pandemic, it allowed affected borrowers of federally-guaranteed mortgages to request forbearance related to paying contractual loan obligations. Many borrowers of non-federally guaranteed mortgages and other types of credit were offered comparable forbearance options. The federal government also embarked on an ambitious policy of providing direct financial assistance to consumers and borrowers, such as stimulus payments authorized under the CARES Act, the *Consolidated Appropriations Act of 2021* (HR 133), and the *American Rescue Plan Act of 2021* (HR 1319). Businesses and consumers alike deposited unneeded funds received from the federal largesse into bank deposits for safekeeping. Member banks did not need advances. At the same time, the Federal Reserve adopted an ambitious accommodative monetary policy reducing interest rates to the zero-bound and simultaneously purchasing massive amounts of Treasury, agency and corporate securities; the various programs expanded the Federal Reserve balance sheet to almost $9 trillion. The consequence of these actions was to sharply reduce risk premiums on securities and squeeze Bank profits from agency MBS. Governmental actions, not poor management, penalized the System during the pandemic.
- **Large Bank Focus:** A few commentators criticize the Banks for disproportionate lending to large bank members. It is important to note the structure of banking has shifted. Prior to the *Great Recession*, there were 15 large banks with assets exceeding $100 billion relative to about 7,800 banks across the United States. Many banks failed, merged or were acquired. As of 2021, the number of large banks doubled to 30 while the banking sector shrunk to 4,900. Large bank assets increased from 56% of the sector prior to the *Great Recession* to 68% post-pandemic. Those criticizing the Banks for catering to large banks do not recognize any company must meet the needs of their customer base. Almost 70% of the nation's banking assets are controlled by large institutions. Regulation and law preclude the opportunity to expand the membership base. However, given the dramatic shift in the origination of residential mortgage loans by non-banks, Congress and the FHFA must support consideration of expanding membership to such entities.
- **Inflation and High Interest Rates:** The Federal Reserve again pursued an accommodative monetary policy too long and that blinded them to the emergence of inflation as the pressures of the pandemic eased in 2021. Even when acknowledging inflation early in 2022, the price pressure was viewed as "transitory." Belatedly, the central bank adopted a

policy to increase interest rates by unusually large increments and scaled back the massive investment portfolio acquired during the *Great Recession* and the pandemic. The consequence of monetary actions is higher interest rates leading to market value losses on Treasury and agency debt. Member banks with large available-for-sale (AFS) portfolios suffered losses recorded on the balance sheet not the income statement. Depositors began withdrawing funds from members as alternative market investments offered higher interest rates than banks elected to pay. Rather than securing liquidity by liquidating securities for a loss that would flow through the income statement, members elected to once again turn to the dependable System for funding. Advance balances at the 11 Banks ballooned and Core Mission Achievement Ratios surged. The System is a reliable source of liquidity. However, as market value losses from AFS investments are recorded by members, accumulated other comprehensive losses (AOCI) mount. These losses are temporary until interest rates again decline during the next recession. The FHFA must readdress their policy of restricting advances to members when AOCI exceeds equity (common stock and retained earnings). Interest rates go through a business cycle and so do AFS portfolio values. Members should not be denied access to advances if the AOCI is related to interest rate changes on the value of Treasury and agency debt. Regulation can precipitate a liquidity crisis in the banking system when one need not exist.

- **PLMBS:** Highly-rated PLMBS investments by selected Bank have also been criticized by commentators. The securities ultimately proved to provide interest income well above credit losses and must be viewed in retrospect as a "good" investment. However, the higher risk securities exposed Banks to undue regulatory oversight, needless auditor concerns, incremental operating expenses and expensive litigation to offset some losses incurred from misleading disclosures regarding credit quality of collateral. Although the PLMBS investments were housing-related (other Bank investments have not always met that claim), the incremental expense and oversight are not commensurate with the System's mission. I agree with commentators critical of PLMBS investments or securities that are deemed comparable.

I fully support the FHLBank System. First, the Banks provide a valuable source of liquidity to members large and small. Many members prefer to deal with regional Bank staff knowledgeable of their asset/liability management and local community; there is little reason to consolidate the System's 11 Banks. The System supports AHP but could and should provide more financial backing to low-income families and distressed communities. Second, given the structure of the US banking system, advances must be tilted heavily toward large members. Third, the System is able to expand and shrink assets with little impact on capital ratios. The System's contraction during the pandemic simply represented the unintended consequence of massive fiscal spending and an unusually stimulative and accommodative monetary policy. Fourth, the FHFA must readdress their policy of restricting advances when members have large AOCI losses due to interest rate risk on Treasury and agency investment securities retained within an AFS portfolio. Otherwise, the FHFA could precipitate a liquidity crisis in the US banking system as interest rates continue to rise. Fifth, the criticism of selected Banks investing in high-risk securities, such as PLMBS, is warranted even though such housing-related investments provided outsized interest income relative to credit losses. Finally, the System, Congress and the FHFA must closely evaluate the merits of extending membership to non-banks given such organizations now originate about 75% of residential mortgage loans.

The above comments are due solely to the author and do not reflect the views of the FHLBank of Atlanta or the System. However, the author has been very closely related to the System as a regulator, consultant, and director with total and continuous service amounting to 50 years as of 2023.

Sincerely,

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