Director Sandra Thompson
Federal Housing Finance Agency
400 7th Street, SW
Washington, DC 20024

Submitted via Web site submission

March 27, 2023

Dear Director Thompson:

I am writing today to supplement my letter of September 19, 2022. Again, I am writing in my individual capacity and not as a representative of Devon Bank or the Federal Home Loan Bank of Chicago.

I have listened to a number of the listening sessions and round tables (collectively, "Listening Sessions") and heard support from members who treasure the liquidity provided by the FHLB system, housing advocates who, naturally, advocate for more housing, and critics who make arguments such as "that's just my number" as support for some questionable contentions. Pretty much every participant agrees that there is always room for improvement. What I would like to do with this letter is lay out a half dozen of the basic threshold questions that I see the need for the review process to examine, many of which I have not seen looked at carefully, and which I believe should affect your deliberations on what comes next for the FHLB system.

1. What is an FHLB?

Fundamentally, what is a Federal Home Loan Bank? Is it a creation and functionary of the U.S. government, or is it a private member-owned cooperative? If it is a hybrid, what does that mean? The answer to the basic question is foundational to how most other questions should be answered. The banks may be creatures of statute, but they are SEC-registered companies, with an entire overlapping regulatory system having that status requires, and with shareholders who have rights as owners that are protected by the securities laws. A simple example: a number of participants in the Listening Sessions raised the issue of efficiencies in the FHLB system. Yes, there is room for improvement. But whose concern is managing efficiencies, the government's, or the owners'? It would seem that if inefficiencies do not rise to the level of a safety and soundness threat, or an unreasonable impairment of a particular bank's ability to meet its mission, that under the securities laws (and the Federal Home Loan Bank Act), the business judgement rule would say that managing inefficiencies should be the province of individual FHLB boards, as elected by each banks' membership, and not the FHFA. Is it the FHFA's role to force, facilitate, encourage, or watch and hope for increased efficiencies? The overlap of regulatory systems and the positioning of the FHLBs within that framework cannot be ignored. I would posit that Silicon Valley Bank was put out of business not because of bad investment choices alone, but due to the interplay of regulatory systems— the banking regulators required a bond sale, the bond sale produced a loss, the securities laws required the timely filing of a form 8-k due to the materiality of the loss, the 8-k lead to the real-time public awareness of the loss, the awareness lead to the bank run that overwhelmed the bad investment choices which couldn't be remedied in the limited time forced by the SEC's public disclosure requirements, and thus collapsed the bank. If SVB was privately held, and not subject to SEC reporting obligations, it might still be in business today.

2. What is an FHLB supposed to do?

Congress gave the banks a mission and a name. It then expanded the mission, but not the name. The mission is to help provide housing finance; funding for small businesses, farms, and agri-businesses; and community development. Clearly, there is a statutory mission to address "housing finance," but also to help develop communities in which people would wish to live. Supporting small businesses and farms, and the jobs they create which provide the means for people to buy or rent homes, and supporting the community institutions that make communities livable, are a necessary adjunct to financing homes, as reflected in the statutory language. Whether you focus the mission as promoting "housing finance" or rather financing livable communities alters the focus and direction of the banks.

3. Is the FHLB system supposed to help address the housing crisis, or solve the housing crisis?

Throughout the Listening Sessions, the charge was made that the FHLBs are not doing enough to promote affordable housing. A finding of "not doing enough" requires that you define "enough." This is not a defined term in the Federal Home Loan Bank Act. However, by any measure, the Federal Home Loan Bank system, directly, not including the hard-to-measure indirect funding provided by FHLB members facilitated by advances, is the largest long-term private funder of affordable housing in the country. (Aiding livability of communities, as such, is largely not measured at all.) There is no question that we have a housing crisis in the U.S., and that it is large. There is also no question that the Federal Home Loan Banks should help address this crisis. But there also should be no question that the FHLBanks <u>are</u> helping address the crisis, and that the crisis is too large to be easily solved by them alone. So, what is a reasonable expectation to require of privately-owned companies in providing "enough"? This is a political question that interacts with issues of safety and soundness, and, fundamentally, with the viability of the system as a whole.

4. What is the balance of priorities of the FHFA as a regulator?

If the FHFA's role is to be both an overseer of mission performance, and a supervisor of safety and soundness, how does the FHFA believe these functions should be balanced when they are in competition? They <u>are</u> in competition. A simple example— income can be added to retained earnings, adding to a bank's safety and soundness, or it can be added to the bank's affordable housing grants, which helps satisfy an affordable housing mission, but does not aid a bank's safety and soundness. Similarly, you can encourage creativity and innovation, which some will see as adding risk, or you can scare banks away from innovating (which I believe is happening). I would argue that these are false dichotomies. Income added to retained earnings produces a larger bank that can generate more AHP dollars and can stomach more risk in the creative process. A bank that cannot innovate in real-time risks obsolescence, and thus the inability to satisfy its housing mission.

5. Does the FHFA have a full understanding of the banks' competitive position?
In the Listening Sessions I was able to hear, I heard almost no discussion of the fact that the FHLBs exist as participants in a competitive marketplace. Furthermore, how the FHLBs compete in this marketplace is a primary driver of how much income is created, a portion of which is set aside for affordable housing programs. Competition, profitability, and affordable housing are practically and statutorily intertwined. As the chairman of a community bank, which has shareholders, I have a fiduciary duty to do what is best for my company and its relevant stakeholders. I believe this means my bank should be a member of the local FHLB so that we have access to back-up liquidity that the FHLBC provides, should we need that liquidity, the value of which has again been shown by the recent bank failures. But other than in an emergency, I also have a fiduciary duty to shop amongst the products/vendors we use to best meet the needs of my stakeholders. For instance, if my bank needs money to fund loans, we look at the cost of FHLB advances. We also consider having a CD special. We also look at correspondent credit lines. We also look at the brokered deposit market. We then use the liquidity source that best meets our rate/term/timing/collateral/availability needs. This is often a daily analysis. If the FHLBC is a worse fit than the brokered market, for instance, the FHLBC does not get the business at that time, it then does not make any money on issuing an advance, and it does not have more earnings to use to fund its AHP program.

(As an aside, this competition aspect is also particularly… odd… related to mortgage financing, because, as conservator of Fannie Mae and Freddie Mac, the FHFA oversees the pricing, goals, securitization, and business methods of those GSEs that are both directly in competition with the FHLB's mortgage programs, and which are necessary for those FHLB's home finance programs' viability. How the FHFA carries out its mission in relation to these various housing entities has the effect of creating winners and losers in their competition against each other, and thus affects their profitability and their ability to satisfy their housing mission. Essentially, as the Fannie/Freddie conservator, the FHFA is in competition with the FHLBs, which it supervises.)

6. Is the FHFA willing to risk regulating the FHLBs out of existence?
This question is a necessary outgrowth of the previous question. Simply put, if you raise the costs of doing business, such as requiring additional funds to be set aside for affordable housing, if such a systemic change produces a systemic increase in costs of providing services (rather than just decreasing safety and soundness), then the banks become non-competitive, do less business, make less money, and less money is available for AHP programs. Thus requiring more money for AHP actually produces less money for AHP. Whether the additional AHP requirements are established by increasing the percentage of income set aside, or through minimum bank or system contributions, the effect is the same—it increases costs, and thus decreases the

banks' competitive position, and thus decreases product usage and bank profitability. Can you require more, even if it does affect product costs? Sure. Until the system breaks. I don't know where the breaking point is, and it will be in constant flux with market forces. I am not trying to over-state my case, but does the FHFA know how far it can push the system until it breaks? Please do not find out the hard way.

Thank you for your attention, and I am available to discuss any of these issues further with the FHFA staff should there be any interest in doing so.

Sincerely,

/s/ David Loundy, Esq.

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