March 31, 2023

The Honorable Sandra Thompson
Director
Federal Housing Finance Agency
400 7th Street, SW
Washington, DC 20019

Re: FHLB Comprehensive Review

Dear Director Thompson,

The American Bankers Association (ABA)[1] and the undersigned state banker associations appreciate this opportunity to provide further comments on the Federal Housing Finance Agency's (FHFA) comprehensive review of the Federal Home Loan Banks (FHLBanks). We note at the outset that ABA and a number of the undersigned associations have submitted prior comments, and these are intended to supplement those.

As was noted in a recent American Banker article, the FHLBs are a vital liquidity source for their member institutions and have been since the FHLB System was established. [2] The importance of that role has been highlighted in recent days, with the System raising historic levels of funds in the capital markets to respond to heavy advance demand from members in light of the developments surrounding Silicon Valley Bank and Signature bank.

As noted in ABA's earlier comment letter[3], many changes have occurred in the financial services industry, and with the FHLBanks over their long history. Among those are the 1989 enactment of the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA). That law made significant changes to the FHLBank System, including the extension of membership eligibility for commercial banks and credit unions, the creation of the Affordable Housing Program (AHP) and the imposition of the Resolution Funding Corporation (REFCORP) obligation on the FHLBanks. In 1999, the passage of the Federal Home Loan Bank System Modernization Act as part of the Gramm/Leach/Bliley Act made membership voluntary for all members and expanded access to FHLBanks' products and services. It also required reform of the capital structure of the FHLBanks and transferred many corporate governance responsibilities to the FHLBanks directly. In 2005, the FHLBs became registrants with the Securities Exchange Commission, and in 2008, the FHFA was created, becoming the new regulator of the FHLBs as well as Fannie Mae and Freddie Mac.
Thus, throughout their 90-year existence, the FHLBanks have not escaped Congressional and regulatory oversight and reform. Still, ongoing oversight and review is prudent, and we welcome

[1] The American Bankers Association is the voice of the nation's $23.6 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard nearly $19.2 trillion in deposits and extend $12.2 trillion in loans.
[2] https://www.americanbanker.com/opinion/liquidity-or-housing-why-cant-the-home-loan-banks-support-both
[3] https://www.aba.com/-/media/documents/letters-to-congress-and-regulators/ltrfhfa20221031.pdf

the current comprehensive review. This review, however, must recognize that the FHLBanks' mission, ownership structure and membership criteria are set by statute and can only be changed by Congress. We urge FHFA to be mindful of the limits of its statutory mandate and to focus on ensuring that the Banks are meeting their statutorily defined mission in a safe and sound manner.

FHFA has posed six topics for respondents to consider. With the above history, recommendations and reminder of the mandate of the FHFA in mind, we offer feedback on each of the topics in turn. They are:

1. The FHLBanks' general mission and purpose in a changing marketplace;
2. FHLBank organization, operational efficiency, and effectiveness;
3. FHLBanks' role in promoting affordable, sustainable, equitable, and resilient housing and community investment;
4. Addressing the unique needs of rural and financially vulnerable communities;
5. Member products, services, and collateral requirements; and
6. Membership eligibility and requirements.

The Federal Home Loan Banks' general mission and purpose in a changing marketplace

As FHFA notes on its website "The FHLBanks have been a fundamental part of the nation's financial system for more than eight decades. The System provides its members …with a source of funding for mortgages and asset-liability management; liquidity for a member's short-term needs; and additional funds for housing finance and community development. The FHLBanks provide long- and short-term advances (loans) to their members. Advances are primarily collateralized by residential mortgage loans, and government and agency securities…While the FHLBanks' mandate reflects a public purpose, all 11 regional FHLBanks are privately capitalized and do not receive any taxpayer assistance. During the nation's 2008 financial crisis, the FHLBanks did not take government money, in fact, as other sources of funding dried up, they increased their lending."[4]

By any measure, the FHLBanks have been successful in meeting this mission. The FHLBanks have served as an important source of liquidity for depository institutions, allowing banks to better serve their customers—in particular during periods of stress, including the 2007-2008 financial crisis and the early months of the pandemic. The FHLBanks have also allowed banks to better diversify their funding sources, increasing the safety and soundness of the banking system.

As evidenced in recent days, members continue to need access to liquidity and prioritize FHLBank advances over other sources of liquidity even when other extraordinary sources such as the recent facility announced by the Federal Reserve become available. On Monday, March 13, 2023, the 11 regional banks issued $88.7 billion in gross bond sales, which was the largest single day of issuance in the system's 90-year history. In total for that week, the regional banks

[4] (The Federal Home Loan Bank System, 2022)

issued roughly $150 billion in bond sales to meet the heightened demand for advances.[5] As Ryan Donovan, the President and CEO of the Council of Federal Home Loan Banks recently noted, "As members react to a volatile market and seek stable funding, the Federal Home Loan Banks collectively continue to see heightened demand for our advances. Consistent with our statutory and foundational mission to provide liquidity to our members, the FHLBanks are prepared and well-positioned to continue to address our members' needs."[6]

In a number of the recent listening sessions, some have suggested an approach that would continue to make FHLBank advances available for community banks, but restrict larger banks to the Federal Reserve or other liquidity sources. Such a restriction would gravely undermine the FHLBanks' mission to provide reliable liquidity to their member institutions to support housing finance and community investment. FHLBank members include some of the largest home mortgage originators and investors in affordable housing and other community development activities, including low and moderate income communities, and they rely on the FHLBanks. Further, as recent developments have shown, banks of all sizes can face sudden liquidity shortfalls and need a predictable and reliable source to address those needs on short notice. Taking the FHLBs away from any segment of the industry would be ill advised and make the entire financial system less secure and the likelihood of extraordinary interventions by the prudential regulators more likely – an outcome no one should welcome. Additionally, such a restriction risks undermining the FHLBanks' market presence that enables it to borrow large sums at favorable rates, which would have a negative impact on smaller members.

The existing structure of the System is well calibrated and balanced. Member institutions capitalize the System with their investment and in return receive the benefits of borrowing at generally attractive rates, earning potential dividends on their investment and eligibility for Affordable Housing Program funds (and other community support programs) in lieu of or in addition to potential dividends.

While it is true that the financial system is evolving and numerous new entities compete with FHLBank members in the housing and community development finance arena, those entities do not have comparable capital and other safety and soundness regulatory requirements and oversight as existing FHLB members. Most also do not have the kinds of eligible collateral used to back borrowing from the System in its current form. Given the success of the FHLBanks, it is not surprising that these entities want to join or replicate the System. However, their admission would introduce significant risk to the cooperative System. Allowing entities with vastly different regulation, collateral and oversight into the FHLBank System risks destabilizing it and putting existing members' capital at risk, with potential negative cascading effects throughout the financial system and US economy.

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[5] Source for bond sales is the fhlb office of finance: https://www.fhlb-of.com/ofweb_userWeb/pageBuilder/home)

[6] https://www.reuters.com/world/us/us-federal-home-loan-banks-continue-see-heightened-demand-2023-03-13/]

If there is a demonstrated need to provide these entities with a liquidity source, Congress should enact legislation that addresses that need with a separate new system, ideally with the same level of safeguards that have kept the FHLBank System financially viable and fiscally stable for 90 years. Congress should not, however, attempt to revise or reform the existing System to accommodate these other entities, as doing so would almost certainly destabilize the existing system— potentially destabilizing the stability of the broader financial system.

FHLBank Organization, Operational Efficiency, and Effectiveness

One of the hallmarks of the FHLBank System has been the regional FHLBanks that comprise the System, which make it more responsive to regional and local differences and needs. We note that the existing statutory and regulatory construct of the System permits mergers of FHLBanks that can reduce the total number of FHLBanks, as occurred with the merger of the FHLBank of Seattle into the FHLBank of Des Moines in 2015. While FHLBank mergers are complicated and require significant agreement among members of the impacted FHLBanks and oversight from the FHFA, mergers are possible. We view this as appropriate for a cooperative system.

Some criticize the FHLBank System's regional structure as inefficient and call for a single, unified structure, like that of Fannie Mae and Freddie Mac. Proponents of the current System counter that a single, centralized FHLBank would lose the regional input and awareness of localized needs that has made the existing System responsive.

An alternative to centralization or mergers that the FHLBanks may wish to consider is a shared services model that facilitates delivery of services but leaves decision making with the regional FHLBanks. The System's Office of Finance, which serves all 11 FHLBanks in accessing the capital markets, could serve as a model or even a vehicle for this approach. We believe this issue that should be determined by the member/owners of the FHLBank System, and we encourage FHFA to foster discussion and consideration of this concept to help members determine if voluntary mergers of FHLBanks or centralization of services is desirable. We do not believe, however, that mergers or centralization should be driven by the FHFA or mandated by Congress the FHLBanks are private, member owned and capitalized institutions, and absent a financial or regulatory crisis that requires intervention, changes to the structure and organization of the System should be left to the member/owners.

FHLBanks' role in promoting affordable, sustainable, equitable, and resilient housing and community investment.

There is no question that the United States is in the midst of an affordable housing crisis, and it is appropriate that all participants in the housing finance market play a role in addressing that crisis, including the FHLBanks. However, no single entity can act alone to respond to the crisis. We agree that an appropriate role for the FHLBanks is likely to be some form of expansion of the Affordable Housing Program (AHP) mandate or other, voluntary community support efforts. Members of Congress, including Senator Cortez-Masto (D-NV) and Representative Ritchie Torres (D-NY) have introduced legislation that would expand the AHP mandate, and others, including in the recent listening sessions, have offered proposals to increase the role that the FHLBanks play.

Because the FHLBanks are chartered by Congress, it is appropriate for Congress to set requirements about the level of support they must provide to affordable housing and community development.

An important factor that must be considered in conjunction with these issues is that the FHLBanks are cooperatively owned and have voluntary membership. Changes to the AHP or imposition of other mandates could have unintended consequences. If a mandate is seen as too onerous and negatively impacts the value proposition of membership in the System, members may choose to leave, reducing the profitability of the System and the funding sources for AHP or other mandates. Therefore, it is important that members are involved in the discussions about any increased or additional mandates for affordable housing and community development.

The comprehensive review has offered a forum for furthering those conversations and in bringing all interested parties to the table to discuss viable options. We look forward to FHFA's report and recommendations once the review is complete.

Addressing the unique needs of rural and financially vulnerable communities

This topic is closely related to the FHLBanks' organizational structure. As noted above, the regional nature of the FHLBank System is critical to their ability to identify and support the needs of individual communities, including rural and financially vulnerable communities. Indeed, these are the communities that would be most at risk if the FHLBanks were merged or centralized. As stated previously, we believe that it should largely fall to the members/owners of the System to determine the structure and number of the FHLBanks, but we acknowledge and affirm that the FHFA has a role to ensure that members of these communities get a seat at the table and that their concerns are heard and addressed.

Member products, services, and collateral requirements

Again, this topic is closely tied to that of the FHLBanks' regional structure because each FHLBank determines its products, services and collateral requirements. However, because of the cooperative nature of the System, all 11 FHLBanks and their members have an interest in ensuring that products and services, and especially collateral requirements, are appropriate and do not present undue risks to the individual FHLBanks or the System overall. Beyond that, however, it is a hallmark of the responsiveness of the System to local needs that each FHLBank is able to offer products, services and collateral requirements tailored to their individual members.

For example, some of the FHLBanks chose to expand eligible collateral to include certain agricultural loans when the Federal Home Loan Bank Modernization Act was passed as part of the Gramm/Leach/Bliley Act of 1999. Other FHLBanks, with fewer agricultural focused members, chose not to. Now, with more than twenty years of experience by at least some of the FHLBanks, and a changing landscape, both literally and figuratively, for American agriculture, it may be prudent for the FHLBanks to reexamine their acceptable collateral. In any event, this should be done in consultation with the members/owners of the System to ensure that the FHLBanks are responding to member needs, while also ensuring that the collateral accepted and products and services offered are safe and do not bring undue risk to the System.

Membership eligibility and requirements

As noted above, Congress, by statute, sets the membership eligibility requirements for the FHLBank System. While the comprehensive review – and the listening sessions held thus far – have brought forth a number of proposals to modernize or repurpose the System to allow currently ineligible members to join, that cannot happen without Congressional legislation. Further, it should not happen without careful consideration of how potential membership changes could impact the safety, soundness and long term viability of the System, as well as the capital investment of the current owners/members of the System.

We recognize that the financial services landscape of our country continues to evolve and that non-bank entities play a growing role in housing and other finance. Indeed, many have cited the growing dominance of non-bank mortgage providers as evidence that the FHLBank System needs to be revised. However, even with the growth of nonbank marketshare in mortgage finance, current members of the FHLBank System still – and will continue – to play an important role in housing finance and community development. Indeed, their engagement is more important than ever when the nation faces an affordable housing crisis. In the Mortgage Call Report from Washington State's Department of Financial Institutions, 527 mortgage companies each quarter in 2019 reported lines of credit from primarily FHLB Member Banks, with a median line of credit to a mortgage company that year at $40 million.[7] Many mortgage companies had lines of credit from multiple banks in the data set, and the total of these lines of credit extended to mortgage companies averaged $217 billion each quarter that year. These lines of credit are referred to as "warehouse loans" where mortgage companies borrow predominately from banks for a short amount of time and then the loan is repaid once the mortgage company sells that mortgage on the secondary market. Because these warehouse loans overwhelmingly come from FHLB member banks, it demonstrates FHLB members using advances to assist the

[7] https://dfi.wa.gov/mortgage-brokers/mortgage-call-reports]

housing market. It should also be noted the 527 mortgage companies in the Washington State dataset is only a subset of the 972 independent mortgage companies that submitted to the Home Mortgage Disclosure Act (HMDA) dataset that year. In other words, the number and value of lines of credit from FHLB Member banks to mortgage companies is even higher than these figures suggest.

While non depositories may desire additional liquidity sources, and it may be desirable from a public policy standpoint to provide them with one, it is far from certain that the FHLBanks should be used for that purpose. Doing so comes with considerable challenges, not the least of which is how to accommodate less regulated and supervised entities, which also typically lack the kind of collateral necessary to safely and soundly support the existing cooperative structure of the FHLBanks.

While the comprehensive review may provide a forum for these entities to raise their concerns and make their case for access to a liquidity source like the FHLBanks, it should not become an avenue for the development of proposals by FHFA to change the structure of the System. That action would exceed the authority and mandate of FHFA as the regulator of the FHLBanks. That mandate, to ensure that the FHLBanks are meeting their mission in a safe and sound manner, must remain paramount.

Conclusion

We appreciate this opportunity to provide the FHFA with comments on the topics presented and as well as on the appropriate limits of that review. We look forward to further engagement with the comprehensive review and the follow on in order to promote a vibrant, responsive and safe FHLBank System.

Sincerely,

American Bankers Association
Alabama Bankers Association
Alaska Bankers Association
Arizona Bankers Association
Arkansas Bankers Association
California Bankers Association
Colorado Bankers Association
Connecticut Bankers Association
Delaware Bankers Association
Florida Bankers Association
Georgia Bankers Association
Hawaii Bankers Association
Idaho Bankers Association
Illinois Bankers Association
Indiana Bankers Association
Iowa Bankers Association
Kansas Bankers Association
Kentucky Bankers Association
Louisiana Bankers Association
Maine Bankers Association
Maryland Bankers Association
Massachusetts Bankers Association
Michigan Bankers Association
Minnesota Bankers Association
Mississippi Bankers Association
Missouri Bankers Association

Montana Bankers Association
Nebraska Bankers Association
Nevada Bankers Association
New Hampshire Bankers Association
New Jersey Bankers Association
New Mexico Bankers Association
New York Bankers Association
North Carolina Bankers Association
North Dakota Bankers Association
Ohio Bankers League
Oklahoma Bankers Association
Oregon Bankers Association
Pennsylvania Bankers Association
Puerto Rico Bankers Association
Rhode Island Bankers Association
South Carolina Bankers Association
South Dakota Bankers Association
Tennessee Bankers Association
Texas Bankers Association
Utah Bankers Association
Vermont Bankers Association
Virginia Bankers Association
Washington Bankers Association
West Virginia Bankers Association
Wisconsin Bankers Association
Wyoming Bankers Association