March 30, 2023

Federal Housing Finance Agency

Constitution Center

400 7th Street, SW

Washington, DC 20219

COMMENTS regarding: FHLB System at 100: Focusing on the Future

Dear FHFA,

Thank you for the opportunity to comment on a number of topics related to “FHLB System at 100: Focusing on the Future”. The kick-off listening sessions and roundtables have stimulated important conversation, from a number of perspectives and stakeholders, on many important issues related to the Federal Home Loan Banks (FHLBs). Please note: the views provided below are entirely my own.

The FHLBs provide significant and important value to their member banks, insurance companies, and credit unions, and very importantly, to the communities those banks, insurance companies, and credit unions serve. As a two-time former officer of the FHLB of Boston[[1]](#footnote-1) (the Bank), with 21 years of service at the Bank, I observed that value first hand, and am a steadfast advocate of the FHLBs. My experience was that the board and the employees of the Bank always knew exactly what their mission and purpose were. They were fully committed to the mission and purpose as well. Their focus was always on providing liquidity and funding to their member institutions, for the benefit of their customers and communities, and to support housing, including affordable housing, and economic development in the New England region.

Below are comments on a number of topics that have been discussed during your review:

Mission and Purpose: The FHLBs have a clear and critical mission. The provision of liquidity to their member institutions is a valuable asset-liability management tool on a daily basis, allowing members to secure funding in structures and maturities to match their balance sheet needs and reduce risk (to their organizations, and the US financial system).

In addition, the provision of liquidity by the FHLBs has served the US financial system well during crisis after crisis. Three significant events in just the last 15 years (the recent disruption in the US banking sector following the failure of Silicon Valley Bank (SVB), the market turmoil related to the onset of COVID, and the Great Recession) demonstrate the value of the FHLBs in providing liquidity to their member financial institutions during a time of financial stress in the markets, allowing the members to meet their own liquidity needs and to calm the US financial system overall. The Federal Reserve acknowledged this role of the FHLBs during the Great Recession, noting in a staff paper, “During the first four months of the liquidity crisis, the FHLB was clearly the dominant source of government sponsored liquidity”.[[2]](#footnote-2)

In short, the provision of liquidity by the FHLBs is invaluable to the financial markets in our country and should not be restricted or reduced. And, contrary to the assertion made by one or more in recent weeks, the FHLBs do not add risky leverage to the financial system during challenging times in the economy or markets. Rather, the FHLBs provide substitute funding for institutions that might be experiencing outflows of deposits or other less-dependable funding sources, and/or a temporary cushion of excess liquidity should they need it, thereby avoiding liquidity crises for member institutions, and potentially broader implications for the banking and financial markets in our country.

FHLB Collateral Policies: While every FHLB has its own collateral policies, it is important to note that the FHLBs do generally lend on housing loans or securities, government securities, and other loans. The assertion that they fund risky strategies or mergers and acquisitions or other non-housing activity ignores a basic financial tenet that money is fungible. Indeed, it is hard/impossible to track which liabilities are funding which assets at a financial institution. However, the FHLBs only lend against “eligible collateral”, at a discounted value. Therefore, the FHLBs are indeed “liquifying” eligible collateral. Because of the fungibility of money, is not clear whether deposits, or capital, or other funding sources (such as funding secured in the repo market) are supporting other activities, versus advances.

Safety and Soundness: The FHLBs are a model of resiliency. Their “accordion capital structure”, combined with a significant build up of retained earnings in the past 15 years, and consistently strong, conservative mission-focused management, have arguably put them in their strongest financial condition in their 90+ year history. Strong balance sheets, combined with excellent asset/liability management, and continuous access to the GSE capital markets has seen them successfully weather every financial challenge since the Great Depression. While some argue that FHLB success is due only to their access to the GSE debt market, this has not been the experience of all GSEs, including two housing GSEs that have been in conservatorship since 2008.

The FHLBs are some of the most heavily regulated financial institutions in our country. The FHLBs are subject to annual safety and soundness examinations conducted by the FHFA. In Boston, these have included up to 36 examiners onsite for six weeks at a time. At these levels, there was an examiner onsite for about every 5 employees of the Bank, for six weeks per year. The examiners conduct thorough reviews under the CAMELSO paradigm (CAMELSO = Capital, Asset Quality, Management, Earnings, Liquidity, Sensitivity to interest rates, and Operational Risk (including information security)). In addition, a separate team examines the affordable housing and economic development programs of each FHLB each year, and another FHFA team examines the diversity and inclusion activities of each FHLB each year. In addition, the FHLBs each have well-staffed internal audit departments, external auditors (currently PWC), and are subject to full SEC reporting and review.

My personal career experience includes working at community and regional banks that were regulated by the state, the Fed, the FDIC, and the OCC. FHFA regulation and supervision at the FHLBs is more intense, detailed, and robust than any other regulator I experienced. It is fair to say the FHLBs are extremely closely regulated.

Membership Eligibility: Many have proposed broadening FHLB membership eligibility over the years. The FHLBs themselves have reviewed the notion of expanded membership many times. Given the changes in the mortgage market in recent decades, particularly in the areas of origination and servicing, and given that Fannie Mae and Freddie Mac have unknown futures post-conservatorships, it is understandable that this question would be raised. My conclusion, having participated in many analyses and discussions on this topic, is that if the FHLBs are to maintain their current conservative risk culture, and if they are to be fair and equitable to their current member/shareholders, the opportunities for taking on new types of institutions as members and providing them with access to FHLB products and services in a meaningful way are quite limited. If Congress or the FHFA wants the FHLBs to broaden their membership base, it will require significant analysis of the associated risks, the potential returns for taking on such risks, and how any changes might affect the traditional membership of banks, credit unions, and insurance companies, in terms of their access to liquidity and support for housing affordable housing and economic development. This would involve trade-offs, and a different FHLB System than currently exists, and presumably would require legislation as well.

Products and services: The products and services that the FHLBs provide to their members have largely remained the same for decades. Given the current structure of the FHLBs, current regulatory and FHLB risk tolerances, as well as statutory limits, there are not a lot of potential new product offerings that come to mind. It is certainly in the interest of the FHLBs to become even more valuable to their member/shareholders and other constituencies. There should be ongoing review of the existing advance products, housing product offerings (both AHP and voluntary programs), and other services provided to member financial institutions. However, to consider materially broader product offerings would require additional analysis akin to that noted above in the discussion of potential additional membership. Perhaps one of the beauties of the FHLB System is the very clear limit and scope of the FHLB Statute, which in turn leads to clear regulation, as well as policy emanating from both the FHFA and the FHLBs.

Affordable Housing and community/economic development: The FHLBs fund and implement one of the most successful affordable housing programs in our country. Since implementation following FIRREA in 1989, the FHLBs have contributed $7.3 billion in grants and subsidy to the affordable housing needs of our country, supporting the addition or rehabilitation of over 1 million affordable housing units. The program is unique in that it is administered and customized to meet the needs of each FHLB district. It is considered a gem among all affordable housing programs in the US.

The size of the FHLB commitment to the AHP program has been questioned by some. It has been argued that it could be larger. Given the current financial strength of the FHLBs, it is arguable that an increased commitment from 10% of net income to 15% of net income could be supported. This would represent a 50% increase to the current AHP obligation of the FHLBs. If such an increase were to be implemented, it would be very important to couple it with some relief from the extremely heavy monitoring requirements of the current program, and/or to implement the additional funding through voluntary programs outside of the statutory AHP program.

The ability to resolve the affordable housing needs of our country through the AHP program is admittedly limited, based on finite resources (as it is in so many affordable housing programs). The needs are far and broad, geographically and across various demographic communities, as noted in many of your roundtable discussions. Some have argued that the track record of the FHLBs has been so strong in administering the AHP program that funding from other sources (e.g. other GSEs, Congressional appropriations, or other) could be designated for the FHLBs to put to work through the AHP program. This is an idea with merit and should be considered.

Contrary to some public commentary, FHLB support for housing and economic development is NOT limited to the AHP program. Other important and meaningful support comes from “voluntary programs” at each FHLB. It is also simply NOT true that FHLBs view their contributions to housing and economic development as “capped” at their 10% statutory requirement. Rather, the FHLBs support regional and national initiatives around natural disasters, as well as regional programs customized to meet the specific and unique housing and economic development needs in their region. As an example, the FHLB Boston created two unique voluntary programs called “Helping to House New England” (HHNE) and “Jobs for New England” (JNE). These programs, when combined with AHP, were supported with as much as 30% of net income of the FHLB of Boston during the greatest times of need in the New England region during Covid. The Boston FHLB has contributed over $40 million to the HHNE and JNE programs in the last five years, in addition to $165 million to the AHP over this period. Other FHLBs have developed and implemented their own voluntary customized programs. To be clear, and as borne out in facts and data, the FHLBs view the AHP program as a floor, NOT a ceiling, on their levels of support to housing and economic development.

Corporate Governance and System Structure: Corporate governance at the FHLBs is quite strong. The boards are comprised of more than 50% (but less than 60%) member/shareholders, who have a vested interest in the proper management of their FHLBs. More than 40% (but less than 50%) of FHLB boards are comprised of independent directors. All directors are elected by member/shareholders and are subject to strict term limits. All FHLBs have made significant efforts, and have been successful in, increasing the diversity of their boards (and throughout the FHLBs). The FHLBs also voluntary subject themselves to SEC oversight and review, including the filing of 10-Ks, 10-Qs, quarterly earnings releases, and 8-Ks, as if they were public companies. Further, unlike most banks, FHLB CEOs and other executive officers are not allowed to be on the boards of their Banks. The FHLBs also follow NYSE requirements for director independence. And, as noted above, the FHLBs are subject to extensive FHFA regulation, supervision and examination, as well as internal audit departments and Big-Four external audit firm review. Given the success of the FHLBs in surviving and thriving through every financial crisis since the Great Depression, while continuing to meet their mission for their members and the communities they serve, their governance has proven to be effective.

Operational efficiency: Some have questioned whether the FHLBs operate efficiently, and whether they should be forced to consolidate to a lesser number, or even a single, central FHLB. There are many advantages to the current structure, and it should be left to the member/shareholders to determine whether there should be consolidation.

If the FHLBs are viewed to be inefficient, their member/shareholders have economic incentives to make their FHLB more efficient. Economic efficiency of consolidation should be balanced and measured against the value of a regional bank to its members and other constituents (including affordable housing and economic development beneficiaries) in terms of local control, local product development, affordable housing program considerations (including the valued input of Regional Advisory Councils) customization, etc.

Further, given the wholesale nature of the FHLBs, their overhead cost is relatively small compared to most financial institutions. As such, the cost benefit of a merger is smaller. The typical G&A costs of FHLBs is about 15 basis points on assets (versus 200-400 bp for a typical banking institution). In a typical banking institution merger, cost savings are about 50% of the G&A costs of one of the merger participants. So, if two FHLBs of similar size with G&A costs of 15 basis points merged, the combined G&A of the merged entity would be approximately 11.25 basis points on assets of the combined entity. Those modest potential savings would then need to be valued vs. tradeoffs on control issues and preferences discussed above.

Another consideration regarding consolidation that is often overlooked is the value of diversity of thought and management of many FHLBs vs one. Importantly, each FHLB has its own board, its own management, and its own unique membership. If all product development and delivery were to be consolidated to a single national point of control, there would be less customization allowed for FHLB customer stockholders. Further, in the current structure, if one FHLB were to make a grave mistake in its own financial management that led to financial problems, it would likely be able to be merged into another FHLB, or potentially receive support from the 10 other FHLBs if necessary. If there is only one nationalized entity, and a strategic error is made, that one entity would likely fail on its own and enter into conservatorship at the Federal Government’s expense as we have seen with other housing GSEs. Why concentrate all of the FHLB System product offerings, governance, and risk into one board or one management team for a couple of basis points on assets?

Compensation: FHLB executive compensation has been questioned by some commenters, and the FHFA. It is noteworthy that one outspoken critic on this issue received over $1 million in compensation during his tenure as a director, as reported in annual 10Ks.

FHLB directors take their roles seriously, work hard, and help to oversee very sizable and complex organizations. Based on market studies for comparable positions, and with FHFA non-objection, they typically receive $100-125k per year for their commitment of several days for each of 6-8 meetings per year. Given this, a $1+ million salary for a FHLB CEO seems entirely reasonable for being responsible for the entire operation of a FHLB, 365 days per year.

FHLB executive compensation is not unreasonable. Management of the FHLBs is a complex job, requiring broad and specialized knowledge and experience. Each of the FHLBs is $40 billion or larger in asset size. The asset/liability management and risk exposures that must be managed are numerous and extensive. As noted above, the Banks are subject to examination in each of the CAMELSO risk areas, as well as in the areas of AHP and OMWI (Office of Minority and Women Inclusion). Beyond that, each CEO is accountable for staffing and overseeing a minimum of the following functions: Finance/Accounting, Treasury, Legal, Risk Management, Information Technology and Security, Human Resources, Member Services and Marketing, Affordable Housing, and Women and Minority Inclusion.

FHLB compensation practices are robust, fair, and heavily reviewed. Each FHLB contracts with an external compensation consultant annually to review position descriptions and market based compensation for similar positions in banking and financial services. Each FHLB board of directors then reviews and approves the proposed compensation for submission to the FHFA. As noted above, approximately 60% of board members are shareholders, which provides incentive for managing compensation expense. The other 40% of board members are independent directors who bring differing experiences and knowledge to the discussion, and who, as fiduciaries, are inclined to manage compensation expense reasonably. The board is also responsible for making sure they have adequate human resources to staff the bank and to manage the risks of the operation. The FHFA reviews all executive compensation to ensure it is not unreasonable. Further, each board engages a third party compensation consultant for a full review of total compensation at their respective FHLB every few years, and discloses the results in detail in their 10-K. Every shareholder can see the periodic review included in the 10K, and the actual compensation of every named executive officer in the FHLB every year. If they have questions or concerns, they can raise such concerns to a FHLB board member or board of directors. It is clear that FHLB compensation is subject to extensive review by each board of directors, by the FHFA, and by shareholders, with assessment, review, and input from independent consultants who are experts in the field and the market.

Some argue that that FHLBs are less complex and less difficult to manage than traditional banks, are more “government-like”, and management should be compensated less because the FHLBs have the implied guarantee of the US Government on their consolidated debt obligations.[[3]](#footnote-3) If the implied government guarantee somehow diminishes the challenge of managing a FHLB for executives (and presumably the boards), then the same should be true for “too big to fail” (TBTF) financial institutions, as it is presumed the US Government would not let them fail. Further, it would follow that all other insured depositories in the US are essentially government entities, as their primary source of funding is insured deposits, backed by the explicit full faith and credit of the US Government. Obviously, this is not how insured depositories are viewed in the market, nor how executives are compensated in insured depositories. Nor should FHLBs be viewed in such a manner. Rather, markets should set the price for the required skills and experience to run the FHLBs.

[As an aside, given the large value ascribed to the implicit government guarantee of the FHLBs by some critics, it would be interesting to calculate the value of the implied government guarantee and the explicit full faith and credit guarantee provided to TBTFs and all insured depositories, using the same logic and methodology]

It should also be pointed out that FHLB staff is not compensated with equity option and share grants, that can have significant upside potential in fully private sector publicly traded financial institutions. Creating a robust phantom equity program as a compensation component for FHLB executives would further align the incentives of management, shareholders, and other constituents, and should be considered.

Some suggest that FHLB executives should not get paid more than Federal Reserve Bank executives. The Federal Reserve Bank presidents are highly capable, smart, and committed individuals. They are indeed held in high regard. The jobs of FHLB and Fed presidents differ, however in several ways. Federal Reserve Banks are part of one balance sheet that is managed centrally. Therefore, they do not manage all of the CAMELSO risk factors noted above. Also, Federal Reserve presidents hold jobs that are in significant part public policy positions, and often come out of an academic, rather than a financial institutions, background. They also are eligible for substantial pensions and may receive meaningful speaking fees, academic appointments, or board positions upon retirement. So, the jobs are very different, and the market subscribes differing compensation for the respective positions.

Commentators who suggest there is need for change (reduction) in FHLB executive compensation, may not have a full understanding of the market value for the skill sets needed, nor an understanding of the full operations of a FHLB. My experience has been that the executive leadership of the FHLBs is a remarkably talented, hard working, and committed group of individuals who are worth everything they get paid and more. Frankly, if those who are critical of FHLB compensation think it is unjustly high, they should seek to secure an executive position at a FHLB (if they are qualified).

Closing: Thank you for this opportunity to comment on a number of topics included in your FHLB System at 100 initiative. The FHLBs have been successful, important institutions in our financial markets throughout their history. They provide significant and important value to banks, insurance companies, and credit unions in our country, and to the communities those member institutions serve, as well as to the overall US financial system.

As you consider the appropriate role of the FHLBs going forward, I commend you to focus on continuing to develop the good work the FHLBs do, to balance the few voices of dissent that may come from personal discontent or extreme ideology, and to thoroughly analyze the risks and returns of well- intentioned proposals to increase access to membership or to increase financial support for external (and deserving) beneficiaries.

We should not politicize the FHLBs, nor seek to meet any individual agendas. Rather, we should all advocate for the continued strength, good governance, and value of the FHLBs, allowing them to continue to fulfill their mission for another 100 years.

I would be pleased to discuss any of the topics above, or others, in more detail if helpful.

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1. 1988-1997, several economic and finance roles, concluding as EVP and CFO, and 2009-2021 President and CEO [↑](#footnote-ref-1)
2. Federal Reserve Staff Report: “The Federal Home Loan Bank System: The Lender of Last Resort?”, Ahscraft, Bech, and Frame, Staff Report no 357, November 2008, p 19. [↑](#footnote-ref-2)
3. While not arguing the implied government guarantee, it is notable that the very first page of every FHLB debt offering circular includes the following text on the front page, in bold capital letters: **THE BONDS ARE NOT OBLIGATIONS OF THE UNITED STATES AND ARE NOT GUARANTEED BY THE UNITED STATES**. [↑](#footnote-ref-3)