On February 10th 2023, the Brookings Institution and Boston University School of Law jointly hosted the Forum on the Future of the Federal Home Loan Bank System. The below summarizes four key takeaways from the program. Those who were unable to attend the event and wish to see more can view the video [here](https://www.youtube.com/watch?v=eFAEl8Zv6nA&t=503s).

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Nearly a century ago, Congress created the Federal Home Loan Bank system (FHLBs) to promote home ownership and provide liquidity to thrifts (savings and loans) and insurance companies that primarily provided mortgages at that time. Today’s financial system is radically different: Thrifts are synonymous with banks; mortgage lending originates from within and beyond the banking system; and securitization has become the driving force for liquidity in the housing finance marketplace. In light of these systemic changes, it is time to reassess the purpose and mission of the FHLBs. Their regulator, the Federal Housing Finance Agency (FHFA), has launched a comprehensive review.

The Brookings Institution’s Center on Regulation and Markets, Boston University’s Review of Banking & Financial Law, and Boston University School of Law co-hosted a forum to discuss and debate how the FHLB system is working, what its mission should be, and what reforms, if any, should be undertaken. We heard from a wide range of experts, including current FHFA Director Sandra Thompson, former FHLB regulators, affordable housing advocates, and leading academics and researchers. Here are four key take aways from the event, which can be watched in full here.

1. ARE THE FEDERAL HOME LOAN BANKS FOCUSED ON THEIR MISSION TO PROMOTE HOUSING?

The homeownership rates for white households was 75%, compared to 45% for Black households

Supporting housing finance is the original purpose of the FHLB system, but there is no requirement that members use FHLB advances to promote housing. Lisa Rice, president and CEO of the National Fair Housing Alliance, described the mortgage market system’s problematic institutionalized preference toward white Americans, noting that mortgages were not “made universally available to people… [these policies] systematize the association between race and risk in our financial markets that is still with us today.” She called on the FHLBs and the broader housing finance system to prioritize reducing the racial disparity in homeownership. In the second quarter of 2022, the homeownership rates for white households was 75%, compared to 45% for Black households, according to the Department of Treasury. At nearly 30 points, the racial homeownership gap is higher today than it was in 1960. She cited small mortgage loans (under $150,000) and special purpose credit programs as models to be promoted.

Ms. Rice urged “bold,” not “incremental,” change for the FHLBs while Kathryn Judge, Harvey J. Goldschmid Professor of Law and vice dean at Columbia Law School, called this an “exciting moment” for rethinking the role of the FHLBs.

Panelists brought up the case of Silvergate Bank, a bank that primarily supports cryptocurrency actors which borrowed heavily from the FHLB system, particularly in recent times of stress, as an example of how the FHLB system’s focus has strayed far from housing. The conversation highlighted that the FHLBs focus on the type and quality of collateral for their advances rather than the purpose for which the banks use those advances.

Those advances generate profits and the FHLBs have long been required to pay a share of their profits toward affordable housing through the Affordable Housing Program (AHP) they administer. Luis Cortes, founder and CEO of Esperanza and a former member of the FHLBank of Pittsburgh’s board of directors, asserted that FHLB provisions do not go far enough, stating that the current rate of 10% of profits for AHP amount to “getting gamed by the membership,” given the value the FHLBs provide to their members. He stressed that the role of government is not recognized and that a 50/50 partnership is in order. George Collins, former chief risk officer for the FHLBank of Boston, agreed, citing an annual government subsidy of $5-$6 billion for the FHLBs shifting the burden of progress onto member banks. “I really think that it’s in the best interest of the members to jump forward here … because the members get a lot of benefit from the home loan bank system.”

Julieann Thurlow, president & CEO of Reading Cooperative Bank in Massachusetts and chair-elect of the American Bankers Association, raised another key purpose of the FHLB system: to promote community banks and their ability to lend and serve locally. She discussed the value FHLBs provide to community banks, stating: “It is foundational as far as a liquidity source.” The mortgage market structurally has moved toward commoditization whereby mortgages are originated by national lenders (often non-banks), sold into securities, and then serviced by for-profit specialized servicing companies. Thurlow pointed out the value that community banks bring, as individuals can “walk through the front door of a community institution,” not resorting to a 1-800 number. One of the many lessons of ‘08 Financial Crisis and housing market disaster is that just originating a mortgage is insufficient, unless that mortgage is sustainable, which requires adequate resources should the borrower encounter financial difficulty.

2. ARE THE FHLBS PROPERLY REGULATED?

Congress created the FHFA to better regulate the FHLBs during the midst of the financial crisis in 2008. FHFA replaced the Federal Housing Finance Board, whose former chairman Bruce Morrison, made the point that a government-sponsored entity (GSE) “…should not exist unless they have a clear public purpose, and they perform that purpose … it’s not good enough that they’re safe and sound.”

Professor Judge built upon this point, connecting the recent Silvergate lending episode to questions about whether FHLB regulation even considers what purpose banks are using the GSE subsidy for: “[This] might actually not have been a failure of supervision, which begs a much bigger question about the mission drift … supporting a bank that could corrupt the perception of safety and soundness of banking system generally.” She posed the question of how access to FHLB liquidity may have influenced the risk appetite of Silvergate. This exposes the tension between the FHLB system and the Federal Deposit Insurance Corp (FDIC) as the ultimate guarantor of system advances.

“Total avoidance of bank failure is not necessarily a good thing”

The FHLB system is designed to provide liquidity for its members, but due to the FHLB’s super-lien priority over the FDIC, they can shift any lending losses to the FDIC’s deposit insurance fund when a member bank fails. Brookings’s Aaron Klein argued that total avoidance of bank failure is not necessarily a good thing, as some banks that make bad business model decisions deserve to fail. He cited a paper by fellow panelist Scott Frame, Vice President of the Federal Reserve Bank of Dallas, “The Federal Home Loan Bank System: The Lender of Next-to-Last Resort?” as evidence that the FHLB system acted as a lender-of-first-resort to some of the largest originators of subprime mortgages who eventually failed (or would have failed) during the housing and financial crisis of 2007-2009, IndyMac being the prime example. Frame commented that the regulatory problems remain, saying “The primary regulators don’t have any particular say, certainly about any specific advance or anything. This is a business arrangement between the members and their home loan bank.”

Former FHFA Director Mark Calabria, who helped write the law creating FHFA while a senior staffer for Senator Richard Shelby (R-AL), noted the structural limitations of the current regulatory structure: FHFA regulates the FHLBs, but FHLB members are regulated by federal and state banking regulators and state insurance regulators. This was not always the case. Until the 1980s, as the prior regulator of FHLBs, the FHFA also regulated thrifts who were then the major members of the FHLB system (along with insurance companies). This raises questions of inter-regulatory coordination, particularly between liquidity lenders such as the Federal Reserve and FHLB, supervisors, and the FDIC as receiver of failed banks.

3. WHAT REFORMS SHOULD BE MADE?

Michael Stegman, from the Urban Institute, observed that considering executive compensation at the other GSEs may prove fruitful. “The GSEs have a scorecard where performance is tied to … mission-critical activities … we ought to think about how that kind of incentive … can influence compensation.” Klein agreed with Stegman’s idea on executive compensation. He added three ideas: restricting banks to membership in a single FHLB; a restriction on how much one FHLB can lend to a single member; and greater FHLB participation in supporting lending for projects that fill the gap between five to 49 units and mixed-use development. Dennis Shea, executive director at the J. Ronald Terwilliger Center for Housing Policy, stressed that regulators should do more about housing supply. “This area of five to 49 multi-family [housing], which has been traditionally underfinanced, is a worthwhile idea.” Furthermore, on the issue of transparency, Shea asserted that a government assessment of the value of the taxpayer subsidy provided to the FHLBs and their members and the public benefit they provide would prove helpful.

“Regulators should do more about housing supply”

Megan Haberle, senior director of policy at the National Community Reinvestment Coalition, called for greater regulatory clarity on advances, stating: “Not only tracking the advances, [but] attaching stronger strings to them … we want to make sure the advances are attached to that core purpose.” She also called for expanding usage of Community Reinvestment Act (CRA) performance by the FHLBs as well as performance for first time homebuyer support, nothing that under current law many members of FHLBs such as insurance companies and mortgage businesses are not covered by CRA.

Mr. Stegman advocated that GSEs, should not be able to lobby, citing the $3 million spent in lobbying fees in 2021. He also proposed mandating member banks use the community investment program advances to support affordable housing initiatives. The myth of “zero public subsidy” of the FHLBs needs to be dispelled, he said, citing the six notches that the credit rating agencies ascribe to the implied taxpayer support of FHLB debt.

4. VIEW FROM THE TOP

In the keynote fireside chat, Boston University’s Cornelius Hurley interviewed Director Sandra Thompson regarding the FHFA’s review of the FHLBanks’ mission, as well as proposed recommendations for the future. Director Thompson agreed that member banks could do more to promote affordable housing. “They’re fulfilling their liquidity prong very well, but with regard to affordable housing and community investment … they could do better.”

Responding to Mr. Hurley’s question asking whether taxpayers are “stakeholders” in the FHLBanks, Director Thompson responded, “Absolutely,” citing the implied taxpayer guarantee of all FHLB debt and their exemption from paying taxes among the reasons. She also said, “The status quo is not acceptable.”

“The status quo is not acceptable.”

Mr. Hurley inquired about board composition and executive compensation, asking if FHFA can ‘pull any levers’ in the area. Director Thompson directed her answer about executive compensation to the forthcoming report and its recommendations, which will include both legislative and regulatory recommendations. Regarding compensation, she mentioned that she did not set executive compensation levels or ranges but that she has the authority to deny. She offered insight about what diversity in board composition looks like. “When we talk about diversity, not only is it just race, gender diversity, but it’s also diversity with some of the board members and their experiences,” citing an example about representation in districts that have significant tribal communities.