

Alfred M. Pollard, General Counsel  
Attention: Comments/R/N 2590-AA39  
Federal Housing Finance Agency  
1700 G. Street, NW, Fourth Floor  
Washington, D.C. 20552

Sent via email to RegComments@fhfa.gov

Re: Advance Notice of Proposed Rulemaking and Request for Comments – Members of Federal Home Loan Banks (R/N 2590-AA39)

Dear Mr. Pollard,

Thank you for providing us with the opportunity to comment on the Federal Housing Finance Agency's (FHFA) proposed rule changes regarding membership in the Federal Home Loan Bank System. The FHLBank system is an important source of short-term liquidity for banks that lend in the U.S. residential housing market, and we therefore feel that the FHLBank membership criteria is an important issue, and we value this chance to comment. We are four students attending the University at Buffalo Law School and soon-to-be first time homebuyers. We have a keen interest in an effective and stable FHLBank system and in ensuring that we all learn lessons from the recent credit crisis. We hope this comment helps contribute to the furtherance of a sound and economical housing market for generations of homeowners.

#### **EXECUTIVE SUMMARY**

This comment letter addresses Questions 9, 10, 12, and 15 which were posed in the December 27, 2010 Advance Notice of Proposed Rulemaking (ANPR) request regarding membership in the FHLBanks. We answer the following posed questions: (9) should the FHFA revise 12 CFR § 1263.13 to require member institutions to comply with the “home financing policy” not only at the time of FHLB initial membership application but ongoing with continuing membership requirements; (10) should the FHLBank system create a solid definition of “home financing policy,” and if so, what should that definition be; (12) should the FHFA continue using a member institution’s Community Reinvestment Act (CRA) rating as a measure of presumptive compliance with the “home financing policy” requirement, and if not, should the FHFA develop an alternative approach; and finally (15) a discussion of whether the FHFA should play a greater role in resolving “close membership issues” and why it is increasingly important to assure adequate supervision of individual member institutions.

The FHLBank system provides essential liquidity to its member banks to fund housing finance across the United States, and is a valuable tool for financial institutions. Membership into the FHLBank system, however, should also be recognized as a privilege. Membership allows institutions to receive advances at below-market rates. The following recommendations are intended to stimulate discussion about membership requirements and FHLBank member compliance with FHLBank required membership standards. As we collectively enter the post-2008 credit crisis, properly defining the scope and role of the FHLBank system has perhaps never been more important.

In brief, this comment letter will offer the following conclusions:

- The CRA, standing alone, is an insufficient proxy for FHLBank member's compliance with the "home financing policy" requirement
- Assessing "home financing policy" compliance with CRA evaluations alone is redundant and standing alone needs to be changed
- There are portions of the CRA which should be incorporated into a new "home financing policy" compliance measurement and definition
- The FHFA should also use additional housing data in this new test for compliance
- FHLBanks can use this new data to ensure that their members have home financing policies that encourage market stability and affordable housing.

## **BACKGROUND**

### **I. Current FHFA Membership Requirements for FHLBanks are Inadequate and Should be Changed**

#### **A. The FHFA currently exercises little control over FHLBank membership**

In 1996, the Federal Housing Finance Board (the predecessor of the Federal Housing Finance Agency [FHFA]) adopted a final rule authorizing the 12 FHLBanks, rather than the Board, "to approve or deny all [FHL]Bank membership applications."<sup>1</sup> In transferring this authority from government agency to profit-seeking private enterprise, the FHFA's predecessor established "objective yet flexible" statutory eligibility criteria as guidelines for the FHLBanks.<sup>2</sup> The Board originally considered establishing "bright-line eligibility standards" to define these statutory eligibility criteria, but refused to incorporate them into the final rule after coming under fire from commenters.<sup>3</sup> All commenters for this final rule were FHLBanks, bank trade associations or insurance company trade associations.<sup>4</sup> Instead of requiring the FHLBanks to adhere to "bright-line eligibility standards," the Board gave each FHLBank greater discretion in selecting and defending its membership decisions, so long as they meet some minimum regulatory requirements. In 2008, the Federal Housing Finance Board merged into the newly created Federal Housing Finance Agency, transferring its authority to regulate the FHLBanks and its responsibility for ensuring that they "operate in a safe and sound manner and fulfill the missions assigned under their charters."<sup>5</sup>

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<sup>1</sup> Membership Approval, 61 Fed. Reg., 42530 (Sep. 16, 1996) (to be codified at 12 C.F.R. §1263.3).

<sup>2</sup> *Id.*

<sup>3</sup> *Id.*

<sup>4</sup> *Id.*

<sup>5</sup> See Housing and Economic Recovery Act of 2008, 12 U.S.C.A. § 4511 (FHFA has authority for FHLBank supervision).

<sup>6</sup> Notice by the Federal Housing Finance Agency, 75 Fed. Reg. 81276 (Dec. 27, 2010), H.R. REP. NO. 110-142 (2007).

Currently, FHLBank standards for membership admissions are loose. An FHLBank must presume that an institution satisfying minimum membership standards also satisfies the corresponding statutory requirements of the Bank Act.<sup>7</sup> Indeed, even if an institution fails to meet the FHFA's regulatory standards, it may rebut the presumption of noncompliance by submitting additional evidence to the governing FHLBank.<sup>8</sup> In most cases such evidence is as simple as "a written analysis acceptable to the [FHLB]ank" as to why the institution is, in fact, in compliance.<sup>9</sup> Once an institution has passed FHFA standards and is admitted, an FHLBank's Board may directly terminate the institution's membership if it fails to comply with FHFA or Bank Act regulations, but this termination is not compulsory.<sup>10</sup> An institution must demonstrate its compliance with membership requirements only once; there is currently no requirement that an FHLBank continue to assess a member's qualifications throughout their membership in the system.<sup>11</sup>

**B. The FHFA should play a greater role in resolving close membership issues by adopting more refined membership standards (Question 16)**

The FHFA regulates the FHLBank system largely through top-down examination; it establishes regulations to which the 12 regional FHLBanks must adhere and periodically assesses their adherence to these policies. Unlike most other FHLBank regulations, membership requirements allow the FHFA to indirectly control individual member institution behavior because they set standards for their admission. If the membership requirements were to become ongoing requirements, the FHFA would have even greater control over the member institutions over time.

Given the steadily rising dominance of a few large institutions within the FHLBank system and the US housing market as a whole, FHFA's current loosely defined regulations are problematic. When the FHLBank system was first created, small thrifts and savings and loan depository institutions dominated the organization.<sup>13</sup> Today however, several large commercial banks and mortgage originators that have joined into the FHLBank system dominate both the US housing market and the demand for advances from the FHLBanks. By 2006, for example, the now bankrupt Countrywide Home Loans (Countrywide) alone financed about 20 percent of all mortgages in the United States (valued at about 3.5 percent of US GDP), making it the largest mortgage lender and servicer in the country.<sup>14</sup> By September 2007, the FHLBank of Atlanta had a full 78 percent of its total mortgage holdings in collateral for Countrywide's advances.<sup>15</sup> After the incredible losses it suffered in the collapse of the housing bubble, Countrywide was forced to sell itself in 2008.

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<sup>7</sup> 12 C.F.R. §1263.17.

<sup>8</sup> *Id.*

<sup>9</sup> See 12 C.F.R. §1263.17 (d), (e) and (f).

<sup>10</sup> 12 U.S.C. §1426(d)(2)(A)(i).

<sup>11</sup> See FHFA Advanced Notice: Members of Federal Home Loan Banks, RIN 2590-AA39.

<sup>13</sup> Susan M. Hoffman & Mark Cassell, MISSION EXPANSION IN THE FEDERAL HOME LOAN BANK SYSTEM, 38 (2010).

<sup>14</sup> Rhodes v. Diamond, CIV. 09-1302, 2010 WL 2804821 at 10 (E.D. Pa. July 14, 2010).

<sup>15</sup> Schumer: Probe Countrywide Advances (2007), <http://www.thestreet.com/story/10391679/schumer-probe-countrywide-advances.html>.

Large depository institutions like Countrywide have been gradually gaining control of the US housing market, and such market consolidation amongst residential lenders has led to a concentration of credit risk faced by the FHLBank system. Adverse systemic effects of risky, unsound lending practices among individual member institutions of the FHLBanks are therefore amplified. Because the FHLBanks, as private, profit-seeking organizations, proved incapable of effectively monitoring dominant member institutions in the recent foreclosure crisis,<sup>16</sup> increased government oversight is needed. By revising its membership regulations, specifically its “home financing policy” requirement, the FHFA would take an important first step to correcting the insufficiency in lending practices of individual member institutions.

## DISCUSSION

### **II. “Satisfactory” CRA Scores Should not Remain the Sole Proxy for Adherence to the “Home Financing Policy” Requirement (Question 12)**

#### **A. Assessing “home financing policy” compliance with CRA evaluations alone is redundant**

While the FHFA’s current membership requirement governing an acceptable “home financing policy” is exemplary of such inadequately defined standards, its elasticity provides an opportunity for reform. According to the Bank Act, the FHLBanks may admit a member only if:

“[T]he character of its ... *home financing policy* [is] consistent with *sound and economical* home financing.”<sup>17</sup>

While the Bank Act does not explicitly include non-depository institutions, FHFA regulations require that all prospective members satisfy this requirement.<sup>18</sup> Leaving the term “home financing policy” undefined, current FHFA regulations require only that an institution seeking membership have received a “Satisfactory” or better on its most recent Community Reinvestment Act (CRA) performance evaluation.<sup>19</sup> This exact same CRA requirement is required of member institutions every year to assess their compliance with the community support regulation under 12 CFR 1290.3. Successful CRA evaluations are required only once for assessing membership qualifications, but for a member’s community support assessment, the burden is ongoing.<sup>20</sup> In other words, the CRA membership evaluation alone adds no substantively new requirement to member institutions; members are already required to pass their CRA evaluations under a different section of the membership regulations. But then why was the “home financing policy” requirement included by Congress in the Bank Act?

#### **B. The FHFA should define the phrase “home financing policy” according to Congressional design of the Bank Act (Question 10)**

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<sup>16</sup> *Id.*

<sup>17</sup> 12 U.S.C.A. §1424(a)(2)(C) (West)(emphasis added).

<sup>18</sup> 12 C.F.R. §§1263.6 (a)(6), 1263.13.

<sup>19</sup> 12 C.F.R. §1263.13(a).

<sup>20</sup> 12 C.F.R. §1290.3.

**i. Home financing policies that are “consistent with sound and economical home financing” should encourage market stability and promote affordable housing**

According to both Congressional and FHFA regulations, an institution qualifies for the privilege of membership in an FHLBank only when:

- B. the insured [ ] institution's *financial condition* is such that advances may be safely made to such institution; and
- C. the character of its...*home-financing policy* [is] consistent with sound and economical home financing.

12 U.S.C. 1424 (a)(2) (emphasis added)

In drafting its membership requirements, Congress separated its concern for an individual institution’s “financial condition” in subsection B from the requirement that its “home financing policy” be “consistent with sound and economical home financing” in subsection C. This division suggests that Congress intended the “home financing policy” requirement to be separate from regulations governing acceptable financial conditions for individual member institutions. In addition, the use of the phrase “consistent with sound and economical *home financing*” suggests that Congress intended this membership requirement to improve the broader future market for home financing, rather than the current financial condition of any single member.

The Fifth Circuit provided greater clarity on the meaning of the phrase “sound and economical” in the 1981 *Gulf* case.<sup>21</sup> Relying on legislative history, the Court concluded that Congress intended the membership requirement to stem the risk of bank failure in a post-Depression era United States.<sup>22</sup> It recognized that “the possibility of bank failure was a foremost concern during the 1932 session in which [the statute] was written,” and Congress designed the requirement to “den[y] a federal charter to savings and loan associations whose policies [might] lead to *future* insolvency.”<sup>23</sup> This interpretation confirms the reason for the statutory division between Congress’s concern for the current financial condition of individual member institutions and its concern for maintaining a stable housing finance market by promoting sustainable lending practices among lenders.<sup>24</sup>

But the *Gulf* Court and other sources suggest Congress included the phrase “sound and economical” to encourage affordable home lending, another important concern for the post-Depression United States. In *Gulf*, the Court recognized the weight of legislative remarks to this effect.<sup>25</sup> In addition, other policies governing the interaction between the FHLBanks and the individual member institutions suggest a strong focus on providing affordable housing. For

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<sup>21</sup> *Gulf Fed. Sav. & Loan Ass'n of Jefferson Parish v. Fed. Home Loan Bank Bd.*, 651 F.2d 259, 265-66 (5th Cir. 1981).

<sup>22</sup> *See Id.*, quoting 75 Cong. Rec. 14456 (1932) (remarks of Sen. Fletcher).

<sup>23</sup> *See Gulf Fed. Sav. & Loan Ass'n of Jefferson Parish.* at 265 (emphasis added).

<sup>24</sup> Compare 12 U.S.C. §1424 (a)(2)(B) with (a)(2)(C).

<sup>25</sup> *Id.* at 266, citing 75 Cong. Rec. 14453 (remarks of Sen. Watson).

example, FHLBanks are required to sponsor an Affordable Housing Program by providing subsidized advances to member institutions that stimulate the construction and occupancy of low-income housing.<sup>26</sup> Because the Depression-era Congress intended the phrase “sound and economical” home financing” to provide future market stability and affordable housing, the FHFA should provide a “home financing policy” test that implements these dual aims.

### III. The CRA's Insufficiency as a Sole Proxy for HFP Requirement (Question 12)

The FHFA should not continue using a banking institution’s Community Reinvestment Act (CRA) rating solely as a proxy for compliance with the “home financing policy” requirement specified in the Federal Home Loan Bank Act. CRA ratings alone are not useful measures for gauging “home financing policy” compliance because: (i) CRA standards and time schedules for rating banks are extremely subjective and nebulous, varying upon bank size and type; (ii) the legislative intent behind the creation of the CRA and subsequently the CRA rating system is not fully congruent with the aims of the “home financing policy” of the FHLBanks; and (iii) any rating schema that is used to measure compliance with the newly defined “home financing policy” should have a clearly delineated set of penalties for non-compliance. The CRA does not have such a set of penalties and any legislative provision is likely to be more effective when it has “teeth” or some form of enforcement measure behind it.

#### A. Pitfalls of CRA usage alone

Under the CRA, “small banks” have to undergo three forms of tests as part of a CRA examination.<sup>28</sup> There is a “lending test,” an “investment test,” and a “service test.”<sup>29</sup> The lending test considers the amount of lending that the particular bank has undertaken in the “home mortgage, small business, small farm, and community development” sectors.<sup>30</sup> However varied the criteria are for evaluating a bank’s lending activities are, there are no decidedly quantitative metrics that are used to determine its CRA rating. For instance, the implementing regulations for the CRA state that some of the criteria used in grading banks are i) “the *number and amount* of the bank’s home mortgage, small business, small farm, and consumer loans”; ii) the geographic distribution of such loans, including the *amount* of loans made to lower-, middle-, and upper-income borrowers; and iii) the *number and amount* of community development loans made, including their “complexity and innovativeness.”<sup>31</sup> Yet the Federal Financial Institutions Examination Council (FFIEC), in their memo regarding small bank examination procedures, is as vague as possible about the “numbers” and “amounts” necessary to obtain a rating of “Outstanding” or “Satisfactory.”

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<sup>26</sup> See 12 U.S.C. §1430(j) (addressing Affordable Housing Program to ensure easier financing options for homebuyers); under the Program, advances obtained at subsidized levels must: 1) finance homeownership by families with incomes at or below 80 percent of the median area income; and 2) finance the purchase, construction, or rehabilitation, at least 20 percent of the units of which will be occupied by and affordable for very low-income households for the remaining useful life of such housing or the mortgage term..

<sup>28</sup> 12 C.F.R. §25.

<sup>29</sup> *Id.*

<sup>30</sup> *Id.*

<sup>31</sup> 12 C.F.R. §228. (emphasis added).

According to the 2007 FFIEC memo, with regard to lending, “a loan-to-deposit ratio” which is “more than reasonable” given the “institution’s size, financial condition, and assessment area credit needs” earns a banking institution an “Outstanding” rating under the CRA.<sup>32</sup> Conversely, a “loan-to-deposit ratio” which is “unreasonable” given the “institution’s size, financial condition, and assessment area credit needs” earns a banking institution a rating of “Substantial Non-compliance.”<sup>33</sup> Even when it is presumed that the bank examiners charged with determining a CRA rating are competent and will not abuse their discretion, the guidelines they have been given leave them substantially in the dark on how to judge a bank’s activities under the CRA. What is “reasonable” for a loan-to-deposit ratio? 40 percent? 70 percent? What percentage of loans should be directed towards the various demographics—women, people of color—specified under the CRA? In her testimony before the House Financial Services Committee, Sandra Braunstein, Director of the Division of Consumer and Community Affairs of the Federal Reserve, noted that there have been plenty of attempts to introduce hard, quantitative metrics into the CRA rating process.<sup>34</sup> However, such attempts have been met with vociferous opposition by banking industry and consumer advocates and labeled as “credit allocation,” which is not a part of the CRA itself,<sup>35</sup> but would greatly bolster it.

In addition to the criterion used in bank examinations being overly broad, the CRA provides that the frequency of bank examinations depends on a bank’s size and previous CRA rating. The Federal Reserve, for instance, only examines state/regional banks with \$250 million or more in assets and favorable ratings on a 2-year basis.<sup>36</sup> Only if the bank has received a rating that is less than satisfactory will it be examined for compliance with the CRA on a yearly basis.<sup>37</sup> Given the ill-defined criterion for evaluating a bank under the CRA and the varying time schedule which is dependent upon the nebulous rating system, it seems less than prudent to use the result of such an examination—the CRA rating—as a proxy for compliance with a partially undefined “home financing policy” requirement.

The second major reason that an institution’s CRA rating should not be solely used as a proxy for compliance with the home financing policy requirement is that the aims of the Community Reinvestment Act and the Federal Home Loan Bank Act are not altogether similar. Given that the aims of the two statutes are different from one another, it seems that the most effective way to ensure that their primary objectives are reached is to develop individual compliance measurement devices for each. The Federal Home Loan Bank Act and subsequently the FHLBank, as an entity, was developed to promote home ownership in communities throughout America and to lower the cost of such homeownership. The cost of home ownership was lowered by the FHLBank Act’s requirement that FHLBanks provide capital advances to their member banks at favorable, but predetermined rates. Although capital advances can be made to member banks for the purpose of financing small businesses and farms,<sup>38</sup> the primary

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<sup>32</sup> Small Institution Examination Procedures (OCC, FRB, FDIC, and OTS) –13, July 2007 (CRA Ratings Matrix – Small Institutions).

<sup>33</sup> *Id.*

<sup>34</sup> Testimony of Sandra F. Braumstein, Director, Division of Consumer and Community Affairs (Board of Governors of the Federal Reserve System), February 13, 2008.

<sup>35</sup> *Id.*

<sup>36</sup> *Id.*

<sup>37</sup> *Id.*

<sup>38</sup> 12 U.S.C. §1430.

purpose behind the advances is to provide community financial institutions with capital to originate residential home mortgages.<sup>39</sup>

That the thrust of the Federal Home Loan Bank Act is to foment homeownership for broad swaths of the population is evidenced by 12 U.S.C. §1430(j) of the FHLBank Act. With regard to the Affordable Housing Program that the aforementioned section of the Act covers, the purposes for member bank community lending are clearly articulated. These purposes are to: 1) finance homeownership by families with incomes at or below 80 percent of the median area income; and 2) finance the purchase, construction, or rehabilitation, at least 20 percent of the units of which will be occupied by and affordable for very-low-income households for the remaining useful life of such housing or the mortgage term.<sup>40</sup> The CRA, in contrast, was created to ensure that banks were serving the “credit needs of the local communities in which they are chartered.”<sup>41</sup> The CRA does not specifically reference facilitating homeownership, but focuses on encouraging banks to extend credit to businesses owned by women and people of color.<sup>42</sup> Although extension of credit to underrepresented business owners and the creation of non-usurious credit services for lower income community residents is a goal that is similar to ensuring affordable homeownership and access to low cost mortgages, the two are not one and the same. Thus, a bank’s CRA rating should not be used wholly as a proxy for compliance with the home financing policy of the FHFA.

Lastly, the FHFA should not continue to use a bank’s CRA rating as a proxy for compliance with the “home financing policy” requirement because the CRA fails to enumerate consequences for banks that receive a less than satisfactory rating. The CRA has elements which are useful for assessing home financing compliance. However, one of the hallmarks of effective regulation/legislation is some form of inducement to compliance. Given how nebulous the standards are for receiving a high CRA rating, if banks are “presumptively compliant” with the home financing policy merely based on a CRA rating, it is not clear that the FHFA and the FHLBanks will always be achieving their intended goals.

## RECOMMENDATIONS

### **IV. While Parts of the CRA Rating are Useful, a New Compliance Standard Should be Formed Using Additional Data (Question 12)**

#### **A. Certain aspects of the CRA standard are worth incorporating into a new compliance standard**

Given the pitfalls enumerated above with the current system, there is clear need to revise the use of a “satisfactory” CRA rating as a presumptive measure of compliance with the FHLBank system’s “home financing policy” membership requirement. The CRA, standing alone, fails to adequately control for FHLBank members being in total compliance with the currently undefined “home financing policy,” but this does not mean that features of the CRA

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<sup>39</sup> *Id.*

<sup>40</sup> 12 U.S.C. § 1430(j).

<sup>41</sup> 12 U.S.C. § 2901(b).

<sup>42</sup> 12 U.S.C. § 2903(2).



cannot serve an important purpose for evaluation of FHLBank membership or member “home financing policy” compliance. This analysis does not attempt to cull all of the potentially useful CRA-based regulations for FHLBank membership decisions; instead it focuses on CRA concepts that are useful or applicable to FHLBank membership issues.

### **i. Lending benefits of the CRA**

As mentioned, the aims and societal goals of the CRA and the FHLBank Act are not altogether similar. The FHLBank system’s original purpose, and one that it still strives to serve is “[to provide] their members with products and services that assist such members’ and housing associates’ financing of housing and community lending.”<sup>43</sup> Conversely, the CRA is charged with encouraging institutions that accept deposits to “help meet the credit needs of the local communities in which they are chartered consistent with the safe and sound operation of such institutions.”<sup>44</sup> However, the intersection between the aims of the two Acts is unambiguous: credit extension directed at building and servicing American communities. A substantial portion of the lending that the CRA is concerned with involves loans for homes, farms, or small business endeavors. This partial focus fits in line with the foundation of the FHLBank system’s “home financing policy.”<sup>45</sup>

The results of a CRA examiner’s compliance “lending test” are given disproportionate weight in CRA examinations. A look at the Federal Reserve’s implementing regulations demonstrates this lending focus in rating criteria. “The lending test evaluates a bank's record of helping to meet the credit needs of its assessment area(s) through its lending activities by considering a bank's home mortgage, small business, small farm, and community development lending.”<sup>46</sup> This test makes sense in light of the aims of both the CRA and the FHLBank Act. However, the CRA examiners’ regulations show the lending focus twice. First, any institution that receives a score of “outstanding” on the lending test at a minimum will receive a score of “satisfactory” overall when also considering the services and investment tests and other community development initiatives.<sup>47</sup> Conversely, no bank may receive a score of “satisfactory” or higher unless it first receives at least a “low satisfactory” on the lending test.<sup>48</sup>

While it is troublesome that the four examiners of the CRA ratings are not confined to a defined set of criteria to determine the ratings they deliver, the lending activities, including home financing activities, of institutions given a CRA ranking may be allotted extra weight. It is also true that FHLBank members may only receive a “low satisfactory” on their lending tests and still receive an FHLBank compliant score of “satisfactory,” but the FHLBank system can gather some insight into their prospective members lending activity by utilizing that institution’s CRA rating in light of the lending focus.

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<sup>43</sup> Advance Notice of Proposed Rulemaking: Request for Comments, 75 Fed. Reg. 247 (Monday, Dec. 27, 2010) (to be codified at) 12 C.F.R. §1263 (citing to 12 C.F.R. §1265.2).

<sup>44</sup> CRA section § 2901(b).

<sup>45</sup> 12 C.F.R. § 25.22(a)(1) [Office of Currency Comptroller]; 12 C.F.R. § 228.22(a)(1) [Board of Governors of the Federal Reserve System]; 12 C.F.R. § 345.22(a)(1) [FDIC]; 12 C.F.R. § 563e.22(a)(1) [Office of Thrift Supervision].

<sup>46</sup> 12 C.F.R. § 228.22(a)(1).

<sup>47</sup> 12 C.F.R. §228(b)(1).

<sup>48</sup> 12 C.F.R. §228(b)(3).

## ii. Community development benefits of the CRA

Utilizing a prospective FHLBank member's CRA rating lends indirect support to the FHLBank mission expansion. Authors Susan Hoffman and Mark Cassell report in their book *Mission Expansion in the FHLB System* that the main sentiment amongst FHLBank executives of the ultimate purpose of their banks was "housing finance."<sup>49</sup> The housing finance mission is defined as "making home ownership affordable systemically."<sup>50</sup> This mission is inextricably linked with the FHLBank membership requirement of an institution having a "home financing policy."

The housing finance priority of the FHLBank system is still firmly intact, but it is competing to a lesser degree with an expansion into "community development" as a goal within the FHLBank system. Certain FHLBank branches entertain their role in the community development scheme with more vigor than others. For example, Hoffman and Cassell recount an interview with an unnamed FHLBank executive: "[The FHLBank's purpose] is really to positively impact the lives of the people living in our district—focusing just on our Bank—in terms of providing them with a home to live in, a job, and a safe and growing community to live in."<sup>51</sup> As already mentioned, FHLBanks are charged with ensuring that a certain portion of their advances are directed towards multi-unit housing and housing projects for persons with lower income.<sup>52</sup> In 1989, in anticipation of the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA), then President of the New York FHLBank, Brian Dittenhafer, said: "[Member banks and their employees] live and work here. But beyond that, the properties that they finance retain their value and appreciate only if the communities in which the homes and structures are located are attractive and well served."<sup>53</sup> The most "explicit" statement in favor of community development as a key purpose of the FHLBank system is cited to an anonymous regional FHLBank board member: "The challenge through the system is to move community development from a program to a central focus, how the Banks work—to play the role of broker in getting members to participate in community development. The system should be out there and involved in working with members to support community development more."<sup>54</sup>

There is an important nexus between the uses of the CRA as a measure of presumptive compliance for prospective members having a "home financing policy" that arises from the above anecdotal opinions. In a February, 2011 Department of the Treasury and Department of Housing and Urban Development Report to Congress, the Obama administration notes that "Prior to the crisis, the FHLBs suffered from inadequate regulatory oversight, and were allowed to build large investment portfolios that subjected them to excess risk, while providing concentrated funding to banks engaging in unsound business practices."<sup>55</sup> The report goes on to

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<sup>49</sup> Susan M. Hoffman & Mark Cassell, *MISSION EXPANSION IN THE FEDERAL HOME LOAN BANK SYSTEM*, 38 (2010).

<sup>50</sup> *Id.*

<sup>51</sup> *Id.* at 63.

<sup>52</sup> See 12 U.S.C. §1430(j).

<sup>53</sup> Hoffman & Cassell, *supra* note 7, 66 (citing PR Newswire Association, "Federal Home Loan Bank of New York President Says Pending Thrift Bill Preserves Major Source" ((May 19, 1989)).

<sup>54</sup> *Id.* at 66.

<sup>55</sup> Dep't of the Treasury and Dep't of Housing and Urban Development, February 2011 Report to Congress.

support a narrowing of the scope of FHLBank reach, favoring allowing a financial institution to be a member of only one FHLBank, and limiting the total amount of advances, which would impact larger institutions more adversely, but the larger institutions can already access capital markets more readily.<sup>56</sup> The new stated purpose of the FHLBank system, pending possible Congressional review and decision, may be more tailored to the community-level interests of member institutions.

The CRA focuses on an institution's credit responsiveness within that institution's geographic assessment area.<sup>58</sup> This focus can be relatively narrow, and could possibly include many of the smaller FHLBank members who may also be more apt to utilize a potentially limited amount of total FHLBank advances. Therefore, if Congressional mandates should trend with the Obama administration suggestions, the community development initiatives outlined above from FHLBank executives may become a more clearly defined purpose of the FHLBank system.

We advocate that the FHFA consider the shifting purpose of the FHLBank system amid the drive to be more involved holistically within their member's communities: providing affordable housing finance, including lower-income housing and apartment units; community development and property value appreciation; small business loans; and job creation. If the FHFA should properly decide to move away from the CRA as the only measure of a member's "housing finance policy" compliance, the FHFA should continue to utilize a rating or measure that includes a member bank's involvement in community development initiatives, and also focuses on the actual lending activities of FHLBank members and prospective members.

## **B. The FHFA should use additional housing data in a new test for compliance**

### **i. Home Mortgage Disclosure Act (HMDA) data could provide a clearer picture of problems of soundness and affordability**

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<sup>56</sup> *Id.* at 14.

<sup>58</sup> 12 C.F.R. §228 Appendix A:

(i) Outstanding. The Board rates a bank's lending performance "outstanding" if, in general, it demonstrates:

(A) Excellent responsiveness to credit needs in its assessment area(s), taking into account the number and amount of home mortgage, small business, small farm, and consumer loans, if applicable, in its assessment area(s);

(B) A substantial majority of its loans are made in its assessment area(s);

(C) An excellent geographic distribution of loans in its assessment area(s);

(D) An excellent distribution, particularly in its assessment area(s), of loans among individuals of different income levels and businesses (including farms) of different sizes, given the product lines offered by the bank;

(E) An excellent record of serving the credit needs of highly economically disadvantaged areas in its assessment area(s), low-income individuals, or businesses (including farms) with gross annual revenues of \$1 million or less, consistent with safe and sound operations;

(F) Extensive use of innovative or flexible lending practices in a safe and sound manner to address the credit needs of low- or moderate-income individuals or geographies; and

(G) It is a leader in making community development loans.

The ratings for a given financial institution would decrease as the credit focus of that institution shift away from their assessment area.

Because the one-time CRA rating evaluation requirement alone is redundant, ineffective and does little to address Congress’s legislative intent, the FHFA should revise its membership regulations governing the “sound and economical” home financing policy requirement. This redefinition should employ different “bright-line” quantitative metrics for assessing a member’s contribution to a sound and economical housing market.<sup>59</sup> In addressing the goals of the Bank Act, the redefinition should aim to contribute to financial stability and affordability of mortgages in the U.S. housing market. To achieve these dual aims, the redefinition should take into consideration the nuances of America’s modern, post-foreclosure crisis housing finance market.

Instead of using the inadequate blanket CRA test, the new FHFA bright line test should use the richer public data provided by the Home Mortgage Disclosure Act (HMDA)<sup>60</sup> together with U.S. Census and other housing market data. These data sources would provide a richer geographic portrait of the mortgage lending practices of individual member institutions. For each U.S. census tract,<sup>61</sup> HMDA data provides a yearly assessment of the number and types of loans originated, purchased and sold by that institution. Such local level information is also collected on the annual percentage interest rate (APR) on high-interest loans<sup>62</sup> as well as socio-economic characteristics of borrowers. Unlike CRA test scores, HMDA data includes the relevant Metropolitan Statistical Area/Metropolitan Division (MSA), state code and county code for each of these records.<sup>63</sup> The data is also geocoded for use with geographic information system (GIS) software. HMDA data provides a complete picture of the total lending activity of lending institutions instead of aggregates CRA scores, which only assess whether institutions are lending in areas where they have home or branch offices. And under the HMDA, every institution required to report to the CRA must also report the more extensive HMDA data to the Federal Financial Institutions Examination Council, so this additional data is already publicly available.<sup>64</sup>

**ii. FHLBanks could use this data to encourage their members to promote soundness and affordability through membership requirements**

This richer data set, used in a new membership test, would provide for new ways to improve stability of the housing market and access to affordable, socially-beneficial housing. Some examples are described below.

**a. Soundness**

By developing a new test around the more comprehensive data provided by HMDA and subjecting member institutions to the test on an ongoing basis, the FHFA might be able to curb

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<sup>59</sup> See 61 Fed. Reg. 42530 (reporting the FHFA’s 1997 reluctance to institute “bright-line” standards for membership).

<sup>60</sup> See 12 U.S.C.A. §2803 (detailing the data reporting requirements of the Home Mortgage Disclosure Act).

<sup>61</sup> See 12 U.S.C.A. §2803 (2)(a) (data is compiled by census tract for all counties with a population greater than 30,000, otherwise data is compiled for the county as a whole).

<sup>62</sup> See Woodstock Institute Advancing Economic Security and Community Prosperity, (2004) *available at* <http://www.woodstockinst.org/global/global/united-states/> (high interest is defined as having interest rates at or above 3 percent of U.S. Treasury Notes with corresponding terms).

<sup>63</sup> Federal Financial Institutions Examination Council, A Guide to HMDA Reporting: Getting it Right! (June 2010), *available at* <http://www.ffiec.gov/hmda/pdf/2010guide.pdf>.

<sup>64</sup> *Id.*

aggressive lending policies by large institutions in local or regional housing bubbles, and curb the risk of widespread bank failure that these bubbles can cause. The HMDA requires covered institutions to report annually the total number of mortgages purchased and sold for each census tract within a state, including mortgages they sold to an affiliate.<sup>65</sup> By subtracting the total number and size of mortgages sold from the number and size purchased, FHLBanks would be able to assess a member institution's residual housing investment in a given area over a given period of time.

A significant build-up of mortgages in a concentrated number of census tracts could create widespread risk if home values in that area begin to fall below their corresponding mortgage obligations. A 2009 Government Accountability Office (GAO) Report<sup>66</sup> found a significant correlation between this so-called "negative equity" and the percentage of mortgages in serious default during the last foreclosure crisis (2006-2009).<sup>67</sup> Matching information about the geography of these "under water" negative equity mortgages is widely available. For example, CoreLogic, a private company, publishes the percent concentration of such negative equity each quarter for substantially the same Metropolitan Statistical Area (MSA's) as used by the HMDA data.<sup>68</sup>

If the FHFA required the FHLBanks to assess a new "home financing policy" test incorporating this data, they could help stop overly aggressive member institutions from channeling subsidized advances into areas with increasing levels of negative equity and falling house prices. The new test might, for example, compare an institution's existing mortgage position in a troubled area with its overall assets. By redefining an acceptable "home financing policy" to account for the new test, the FHFA could require an FHLBank to terminate the membership of institutions that do not satisfy an acceptable ratio, with or without a grace period.

This new test would accomplish the highlighted dual aims of the Bank Act's "home financing policy" requirement better than existing FHFA requirements. CRA evaluation scores do not evaluate the sustainability of an institution's lending. In addition, current FHFA regulations addressing the acceptable "financial condition" of an institution to receive advances also fail to equate for the effects of overly risky lending. These regulations judge an institution's financial condition solely by its most recent financial statements; they are not proactive and do not take future market risk into consideration.<sup>69</sup> A new test using HMDA data would be useful to correct this insufficiency.

## **b. Affordability**

FHLBanks could also use the richer HMDA data to develop a new test that would encourage affordable housing. HMDA provides statistical data regarding race, income, type of mortgage, and reasons for denial among its information. The US Department of Housing and

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<sup>65</sup> 12 U.S.C.A. § 2803.

<sup>66</sup> State-Level Information on Negative Home Equity and Loan Performance in the Nonprime Mortgage Market (May 2010), *available at* <http://www.gao.gov/products/GAO-10-633R>.

<sup>67</sup> *See Id.* ("Serious default" means that the borrower is 90 days or more behind on their mortgage payments).

<sup>68</sup> CoreLogic Market Trends Section, <http://www.corelogic.com/Products/Market-Trends.aspx>.

<sup>69</sup> 12 C.F.R. §1263.11.

Urban Development (HUD) began using HMDA data in 1992 in assessing whether GSE's Fannie Mae and Freddie Mac did indeed provide affordable financing to homeowners in line with their statutory goals.<sup>70</sup> After encouraging HUD to set goals, the body returned to Congress after reviewing the collected HMDA data. Its report showed that both Fannie and Freddie continued to lag the rest of the market in funding affordable housing loans to lower income families and underserved communities, matching the performance of private lenders in support of providing affordable housing.<sup>71</sup> HMDA data could be used in a similar test to assess the lending practices of member institutions in the FHLBanks.

A new test and redefinition of "home financing policy" would allow the FHFA to eliminate the CRA's loose standards of lending activity and "home or branch office" bias. Proactive test requirements might even help homeowners experiencing significant declines in housing value stay in their homes. CRA scores assess whether an institution is lending in areas where they accept deposits, not necessarily whether an institution is lending in low-income neighborhoods.<sup>72</sup> In addition, CRA scores assess the total lending activity of an institution, not only the number or amount of home mortgage loans made in that area. A new test using HMDA data could require institutions to lend in low-income communities, regardless of where they take deposits. Unlike the CRA test, this new test would involve only home mortgage loans in line with Congressional intent.

In addition, HMDA data would allow FHFA to tailor the type of lending to its most geographically sensitive uses. While a newly defined "sound and economical home financing" might call for a member institution to provide financing for single family or manufactured housing in a rural area, it might require an institution to make financing available for multi-family housing in more densely packed urban areas. Few low-income borrowers can afford a single-family house in a densely packed urban environment for example. HMDA provides information on the number and size of mortgages purchased and originated by each institution for multi-family housing (defined as mortgages on properties of five or more families), single-family housing and manufactured housing.<sup>73</sup> By setting flexible standards for housing type based on a given locality's housing market and urban density, a new HMDA based test would allow for more sensible, geographically-sensitive housing policies. Given the nation's steady urbanization over the last decades, varying this test by geography could help craft more efficient, economical national housing.

A new HMDA-based test could also help channel capital to improve home equity in places with falling housing prices and high instances of negative equity. HMDA data provides geographic information on the number and type of home improvement loans that each institution makes available to borrowers. If the FHFA adopted a geographically flexible test for "sound and economical home financing," it could require institutions to provide financing for home improvement loans in areas with falling or negative home equity. This requirement might prove

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<sup>70</sup> Thomas H. Stanton, GOVERNMENT-SPONSORED ENTERPRISES: MERCANTILIST COMPANIES IN THE MODERN WORLD 81-83 (2002), 1992 Federal Housing Enterprises Financial Safety and Soundness Act [FHEFSSA, Pub.L. 102-550].

<sup>71</sup> *Id.*

<sup>72</sup> C.R.A. § 2901(b).

<sup>73</sup> See e.g., Home Mortgage Disclosure Act Online Reports, [http://www.ffiec.gov/hmda/online\\_rpts.htm](http://www.ffiec.gov/hmda/online_rpts.htm) (providing a searchable database which includes reports of this information).

effective in deflating local housing bubbles and could provide greater incentives for homeowners with mortgages to stay in their homes. These suggestions would need to be conservatively-based on using the HMDA data in order to mitigate risks, but if the more extensive HMDA data is accessed and utilized effectively, these options would provide viable economical options to lower-income families seeking financial options while also minimizing the risk to financial institutions by conservatively establishing what is viable based on the data.

We hope that you have found our ideas and suggestions useful in pursuit of the ANPR regarding FHLBank membership requirements. We have enjoyed working on this comment letter, and we are truly thankful for your time in considering and reading our work.

Sincerely,

Kelly O'Brien  
kobrien2@buffalo.edu

Jonathan Pollard  
pollard3@buffalo.edu

Daniel Kelly  
danielke@buffalo.edu

Scott Ptak  
stptak@buffalo.edu

NOTE: The views expressed by the authors are solely theirs and do not necessarily reflect those of the University at Buffalo School of Law.