To: Federal Housing Finance Agency
Re: FHLBank System at 100: Focusing on the Future,
Date: October 31, 2022

Americans for Financial Reform Education Fund, along with six undersigned organizations, is pleased to submit comments on the Federal Home Loan Bank system. We thank FHFA Director Thompson and FHFA staff for conducting this much-needed review.

The Federal Home Loan Bank system was created at the start of the Great Depression to serve a purpose that has now been rendered obsolete by modern housing finance and banking practices. Federal Home Loan Banks are private, for-profit entities that receive significant public subsidies yet do not provide a proportionate benefit to the public. Today, their main function is to provide liquidity and advances to the 6800 banks and insurance companies that are its member-owners.

In the best of times, the Federal Home Loan Bank system (FHLB) provides a poor deal for the public. Given our current housing affordability crisis and the existential risks climate change poses to our homes and communities, the current situation is simply untenable.

The Home Loan Banks' Original Purpose has been Rendered Obsolete:
FHFA has asked for input regarding the FHLB's purpose and mission in a changing marketplace. The FHLB system clearly does not further the purpose for which it was founded, nor has a modern understanding of its purpose been widely articulated or shared. The Federal Home Loan Banking System was created as a result of a housing crisis, though one much different than we face today.[1] At the time, homebuyers could only receive short-term mortgages of one to five years that required frequent refinancing. With the onset of the Great Depression came national foreclosure and liquidity crises, which made even these short-term mortgages difficult to impossible to obtain.

President Hoover signed the Federal Home Loan Bank Act of 1932 in order to provide liquidity to financial institutions so they could make long-term mortgages available to the US public, stating his goal to "encourage homeownership and for such encouragement it must be possible

[1] For an overview of the history of the Federal Home Loan Bank system, see George J. Gaberlavage, Consumer Federation of America, The Federal Home Loan Bank System: A Chronological Review and Discussion of Key Issues, June 2017, available at:
https://consumerfed.org/reports/federal-home-loan-bank-system-chronological-review-discussion-key-issues/

for homeowners to obtain long-term loans payable in installments."[2] Membership was limited to Savings and Loan banks and insurance companies, all of whom originated mortgages. According to the Federal Home Loan Bank Board in 1937, the purpose of the system was to create a "national reserve of credit for the local thrift and home-financing institutions, so that they might better serve their communities with a continuous supply of home-financing funds and furnish reasonable liquidity for investments in such institutions."[3]

However, the mortgage finance system envisaged by Hoover in 1932 quickly began to change with the establishment of the Homeowners' Loan Corporation (HOLC) by Roosevelt in 1933, followed by Fannie Mae in 1938. Today, securitization through Fannie and Freddie is the dominant tool to provide liquidity in the mortgage market, rather than advances.

Meanwhile, the insurance companies and banks that comprise FHL bank membership have either stopped originating mortgages entirely or have vastly curtailed their mortgage lending activity while nonbanks, who are not permitted to become members, have come to dominate the mortgage lending space: 64% of first-lien mortgages were originated by nonbank lenders in 2021.[4]

The FHLB in 2022

Despite being little-known to the public, the FHLB system is the second largest issuer of dollar-denominated debt in the United States, second only to the Treasury Department.[5] The principal activity of the FHLB system is to provide subsidized cash advances to insurance companies and commercial banks that largely do not do mortgage lending. Advances represent about half of the FHLB's combined assets, and as of December 31, 2021, the system had $349.4 billion in outstanding advances.[6]

Congress requires the system to contribute 10% of its net income to the Affordable Housing Program. which provides an important source of grant funding for affordable housing, community development, and downpayment assistance programs throughout the country. In 2021, this amounted to $314 million in contributions. This funding is much-needed due to our lack of sufficient public support for affordable housing initiatives. However, the 10% contribution is significantly lower than the federal, state, and local taxes the banks would pay if they were not granted tax-exempt status.

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[2] Gissler, Stefan and Narajabad, Borghan and Tarullo, Daniel K., Federal Home Loan Banks and Financial Stability Harvard Public Law Working Paper No. 22-20, June 2022. Available at: https://ssrn.com/abstract=4135685, at 6.
[3] Id., at 7.
[4] Bonnie Sinnock, Nonbanks made the majority of purchase mortgages in 2021, American Banker, June 2022. Available at: https://www.americanbanker.com/news/nonbanks-made-the-majority-of-purchase-mortgages-in-2021
[5] Gissler, Stefan and Narajabad, Borghan and Tarullo, Daniel K., Federal Home Loan Banks and Financial Stability Harvard Public Law Working Paper No. 22-20, June 2022. Available at: https://ssrn.com/abstract=4135685, at 14.
[6] Federal Home Loan Bank Office of Finance, Lending and Collateral Q&A, March 2022. Available at: https://www.fhlb-of.com/ofweb_userWeb/resources/lendingqanda.pdf

The FHLB system also pays significant dividends to its member-owners. In 2021, the banks paid out more than $1 billion in dividends, more than three times the $314 million they contributed to the Affordable Housing Program that year.[7]

Finally, the system pays high salaries to its executives: in 2021, the CEO of the FHLBNY made over $2.7 million.[8] By comparison, the highest compensated executive at the NY Fed earned $430,000. For a quasi-public entity, salaries are excessively high.

How Does the Public Support the FHLB System?

The public subsidizes the Federal Home Loan Bank System in a number of ways. First, by statute, the banks are exempted from federal, state, and local tax. The federal corporate tax rate is 21%, and state and local tax rates of course vary by jurisdiction. Estimating a total tax rate of 25%, the value of the FHLB tax exemption in 2021 was $442.7 million (out of $1.77 billion in net income). In addition to the tax exemptions, Congress has also given the system privileged lien status *vis a vis* the FDIC and an explicit $4 billion line of credit from the US treasury. Of course, as with the other GSEs, there is an implicit government backing well beyond the 4 billion dollar amount.

Additionally, FHLB debt may be purchased on the open market by the Federal Reserve and has privileged regulatory status in the portfolios of commercial banks and credit unions. Federal Home Loan Banks are viewed as bank creditors during the resolution of failed depository institutions and their debt is considered government debt for purposes of securities laws.

Finally, the FHLB system lends to banks at preferential rates lower than they would find elsewhere. If they didn't have access to discounted money, these banks would likely instead borrow from their depositors. This means that US bank depositors lose out on the higher interest rates they would otherwise receive from their banks. Thus the Federal Home Loan Banking System is subsidized not only by taxes, but also by members of the public who are bank depositors.

FHLB and Systemic Risk Implications

During periods of economic stress, members turn to the FHLBs to serve as a lender-of-last-resort, as seen in the early stages of the pandemic and during the 2008 financial crisis. In the beginning of a crisis, demand for advances from the FHLBs increases and the FHLBs usually fund these advances by issuing discount notes.[9] However, demand for FHLB

[7] FHLBanks Office of Finance, Lending and Collateral Q&A, March 2022. Available at: https://www.fhlb-of.com/ofweb_userWeb/resources/2021Q4CFR.pdf, at 47.

[8] US Securities and Exchange Commission Form 10-K, Federal Home Loan Bank of New York, March 2022. Available at: https://sec.report/Document/0001104659-22-036626/fhlbny-20211231x10k.htm#Item11ExecutiveCompensation_142171, at 206.

[9] *Supra*, note 2, a t19-24

debt is correlated with the perceived health of the housing market and the other GSEs, Fannie Mae and Freddie Mac. In periods where investors question the health of the housing market, including 2008 and early 2020, demand for FHLB debt tapers, leading to higher financing costs and less access to debt markets.[10] Investors then turn to the Federal Reserve for liquidity, because unlike the FHLB, the Fed can create true liquidity by increasing bank reserves.

Unfortunately, the increase in advances from FHLBs during the early stage of a crisis can exacerbate a liquidity squeeze as the Fed must provide short-term funding to cover previous advances. Additionally, member banks that have received subsidized FHLB lending may be able to defer adjustments to their balance sheets, at least in the initial stages of a financial crisis. Thus intermediation by FHLBs have the potential to increase systemic risk during times of financial instability.[11]

Recommendations:

The Federal Home Loan Bank system clearly provides a benefit to the banks and insurance companies that comprise its membership. The public, however, does not receive a commensurate benefit despite subsidizing this system both as taxpayers and as depositors in member banks. As the FHFA moves forward with their review of the FHLB system, we recommend the following reforms:

- **Assess Public Contributions the FHLB system:**

The FHFA's review should contribute to a greater understanding of the extent to which the public supports the system. Thus, this process should include a calculation of the present value of the taxpayer's guaranty of FHLB debt, as well as the impact of FHLB cash advances to member banks on depositor interest rates.

- **Substantially Increase Contributions to the Affordable Housing Program:**

The Affordable Housing Program is the FHLB's most significant contribution to the public good, yet the 10% contribution is woefully inadequate given the amount of public subsidy of the system. One path forward for the Federal Home Loan Bank system is to substantially increase its funding for the Affordable Housing Program, with the 21% federal corporate tax rate as a minimum threshold. While Congressional legislation will be required to increase the 10% threshold, there is nothing that currently prevents FHLBs from voluntarily increasing their contributions.

- **Clarify and Expand the Purpose of the Affordable Housing Program:**

In addition to expanding contributions to the Affordable Housing Program, the program's purpose should also be expanded to include an explicit commitment to affirmatively furthering

[10] *Id.*
[11] *Id.*

fair housing as well as to include investments in disaster preparedness and climate resiliency, green retrofits of affordable housing, energy efficiency improvements, and related projects.

- **Enact Executive Compensation Reform:**

If the FHLB system is to remain a publicly-subsidized and publicly-overseen government-sponsored-enterprise, its excessively high executive compensation levels should be reviewed and brought into alignment with public sector salaries.

- **Explore Reducing Inefficiency Through Consolidation:**

A system composed of 11 banks, each with their own high c-suite salaries and IT/security infrastructure must also be addressed by consolidating redundant systems and imposing limits on executive compensation.

- **Develop Stronger Prudential Requirements:**

FHLB members access wholesale funding through the FHLB system and continue to expect FHLBs to provide liquidity in times of financial crisis. However, as discussed above, this demand can cause a liquidity squeeze and increase strain on the Fed. FHFA should set stronger prudential requirements for FHLBs if they are to continue playing this role in spite of the systemic risk concerns outlined above.

Thank you for the opportunity to comment. For more information, please contact Caroline Nagy at caroline@ourfinancialsecurity.org.

Americans for Financial Reform Education Fund

California Reinvestment Coalition
Center for Community Progress
Consumer Action
National Consumer Law Center (on behalf of its low-income clients)
National Housing Resource Center
Revolving Door Project