



## MEMORANDUM

**TO:** Federal Financial Analytics Clients  
**FROM:** Karen Petrou  
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Next week, FHFA will kick off its important new full-scope [review](#) of the [Home Loan Bank System](#) with a belated assessment of a \$1 trillion-plus GSE that has quietly basked in the long shadow cast by its even larger siblings, Fannie Mae and Freddie Mac. Their history tells the sorry tale of GSEs allowed too long to evade careful scrutiny and a tightly-confined mission. Another once-upon-a-time GSE, Sallie Mae, tells a different tale, this time of ill-designed privatization. These are hard lessons but doing nothing is even worse. If FHFA avoids the pitfalls of letting too much pass it by or rushing to ill-conceived reform, then modernizing the Home Loan Bank System could be a boon to economic equality – a meaningful mission and then some.

As a sweeping, caustic study has [shown](#), the System's seclusion has allowed it to escape anything akin to modern prudential safeguards or standards ensuring mission adherence and taxpayer protections. These gaping flaws must be quickly repaired, but the System must be saved not so much for its members, but for what it could deliver if allowed to serve its full potential.

Going back two decades, rules still in [full force](#) allowed Home Loan Banks to hold “acquired member assets” (AMA). This is an artifact of an ill-starred effort by the Chicago FHLB to challenge Fannie and Freddie in the secondary mortgage market. It ended in considerable losses to all Home Loan Banks that tried to be mortgage-finance “partners.” However, the AMA rules go farther and thus could do considerably better.

The AMA standards derive from the System's pre-FHFA regulator, the Federal Housing Finance Board (FHFB). It decided that the System's mission was not just backing member mortgage finance, but also creating “thriving and livable communities.” Heads up, FHFA!

The rules allowed the Banks to do far better than buy nonconforming mortgages at benefit largely to mortgage bankers. Under the rules, Home Loan Banks can also buy multi-family loans. What a difference that could make for loans not suitable for secondary-market backing from the other GSEs at a time of epic rental unaffordability. Home Loan Banks could also purchase the kind of loans that make a material difference to LMI communities – think for example of BofA's innovative [program](#) to provide down payment assistance in LMI communities. The rule could also be read to allow Banks to back credit-risk transfer in which members sold mortgage risk into the secondary market, hopefully not just aping Fannie and Freddie but instead giving members new ways to reduce credit risk and thus capital requirements for the kinds of mortgages that create thriving and livable communities.

Expanding the assets Home Loan Banks acquire from members wouldn't undermine the Home Loan Banks' ability to support member liquidity for continuing mortgage-finance activities, although I would hope that FHFA ensures going forward that this mission is truly met. Going father, empowering the acquired-member-asset program would make the Banks true partners building

thriving and livable communities and provide real return to each dollar of risk taxpayers take in return for FHLB funding subsidies.

What could go wrong? A lot given the Home Loan Banks' history. Making the System earn its implicit guarantee is critical, but simply slapping approval on equality-vital activities will spell disaster if new asset purchases arrive in the absence of stringent FHLB safety-and-soundness and mission-compliance standards. Unlike the System's long-captive regulator, FHFA has finally come of age in recent years and is well-equipped to set appropriate prudential and transparency standards to ensure that a new FHLB equitable-finance mission comes without mishap. With these new safeguards, this new mission cannot begin soon enough.