



GSE Activity Report

Monday, February 13, 2023

FHFA Plans a Firm Hand on the FHLBs

Summary

Following our [initial report](#), we turn here to a more detailed analysis of what's in store for the Home Loan Banks following the [Brookings high-impact forum](#) on Home Loan Banks that are also facing far more unflattering public attention than has been their fate for years. FHFA is clearly intent on substantive change, but the pace of what it does versus what it asks Congress to do is unclear. More clear is that, absent crisis, FHLB reform is on a totally different track than ongoing FHFA work with Fannie and Freddie and fitful Congressional discussions about doing something about the conservatorships.

Impact

As Karen Petrou suggested on a [recent podcast](#), skepticism about FHFA's intentions regarding the Home Loan Bank system were more likely wishful System thinking than policy reality. And so it proved on Friday when director Thompson made it clear that change is going to come. How and when isn't as clear (see below), but so it seems likely soon to be.

What struck us most across all the panels on Friday is the focus on fixing the [prior lien](#). Panelists knew well that the prior lien is set by statute and all were thoroughly realistic about the odds Congress will step in – i.e., zero absent a crisis. Still, several solutions ready for implementation were also advanced.

That's not to say this is going to be easy. Sandra Thompson said that the FHFA will work with a member institution's primary supervisor to ensure safe FHLB lending. As we [noted last week](#), this is a nice thought but it may prove challenging due to the cone-of-silence required by law for supervisors regarding their views about an individual bank or thrift's financial condition unless – and this is a significant unless – the agency qualifies under the law's limited exceptions. We don't think FHFA does, but supervisors may find a way through this obstacle should they wish to do so as well they might.

Another near-term idea is that the FDIC set conditions on drawing advances when an insured depository hits certain thresholds. This is required by law when it comes to a borrowing bank for members with negative tangible equity and the FDIC could well adopt something akin to its restrictions on [brokered deposits](#) when it tightens standards now-Chairman Gruenberg strongly protested when they were finalized a couple of years back.

Another high-priority reform with less strategic consequence but a good deal of pain for System insiders would be executive-comp restrictions. These received a lot of unfavorable commentary on Friday and are within the scope of FHFA's regulatory authority. More diversity and fewer conflicts on Home Loan Bank boards is also doable and may well get done.

FHFA also clearly wants to make the Banks do better on affordable housing, but whether the extent to which it can raise current levels is uncertain. More certain is tightening up the rules as to what qualifies

for AHP credit and how this needs to be documented over time. While this will ultimately need a regulatory or even statutory rewrite to push the Banks where Thompson wants to get them to go, supervisory guidance can move the needle under current rules and this seems likely in the near term if the agency chooses to use the full scope of its authority to force FHLB change.

Outlook

Will it?

Although Thompson was firm that System reform will follow upon the end of all its listening sessions, she was far less definitive about whether it will come by way of an ANPR – read, after forever and perhaps never – or supervisory guidance. Our forecast is for a combination – an ANPR seeking views on the issues FHFA will flag in a forthcoming report as key to statutory reform and near-term supervisory and/or regulatory action on affordable housing, safety and soundness without the benefit of the prior lien, and governance rewrites.