GSE Activity Report

Wednesday, November 8, 2023

Rebirth at 91

Summary

Although FHFA calls its FHLB report a centenary event ahead of the System's 2032 birthday, the agency clearly plans structural substantive reform well before that milestone. Much of what's planned will crimp FHLB profitability, increasing the importance of what would otherwise seem like tidying-up operational improvements to protect the viability of the System's weaker Banks. With its eye on keeping the System in line, FHFA does not even suggest it should be allowed by law or regulatory sleight-of-hand to issue MBS or like-kind instruments, get into the CRT business, or do anything much but provide ordinary advances to mission-focused members and up its own contributions to affordable housing. A series of near-term regulations are also contemplated to ensure tighter mission compliance and more certain resilience, steps sure also to cut into the Banks' already-challenged bottom lines.

Impact

Many in the System thought FHFA would bless their role as a lender of almost-last resort ahead of or in concert with the Federal Reserve, but we've long doubted this would occur. The reason is simple: Sandra Thompson is not about to put her fingers in the eyes of the Fed, FDIC, OCC, and – so we hear – Secretary Yellen when it comes to the System getting lots for loans that then sharply increase FDIC resolution costs due not only to the prior lien, but also the System's refusal to allow Signature Bank to reclaim collateral during the bank's desperate effort to use the Fed's discount window.

Indeed, FHFA now reveals that the Banks are in the process of negotiating agreements with the Fed quickly to transfer a member's collateral to the Fed for use as a discount-window backstop. In short, FHLB collateral moves from the Bank to the Fed under stress, supporting discount-window advances by a troubled insured depository – not more advances. This a requirement that will ensure as nothing else can that Bank lending to troubled banks will get shorter and shorter term and then dry up altogether if the Fed deems this necessary.

And, even if a Home Loan Bank is feeling generous or, less nobly, counts on the prior lien, FHFA plans new standards that reduce permissible exposures to a single counterparty. FHFA also plans new capital-planning and stress-test standards, standards that can define limits on tangible equity for IDI borrowers, reset capital ratios, and otherwise adjust certain statutory provisions long deemed to stay FHFA's supervisory hand when it comes to reducing FHLB risk.

FHFA would also like to see the Banks' AHP requirements doubled, but that takes Congress. Since it isn't planning to wait up, the agency also intends to press more mission focus through new rules establishing mission-compliance metrics and new examination requirements that sanction Banks that don't measure up. FHFA also plans a rulemaking to press the Banks to support affordable housing and "equity" via actions such as discounted advance pricing or preferential dividends to mission-focused members, with the focus here on small ones. Guidance followed by a rule will also mandate that each Bank better assess mission needs in its district so the Bank and FHFA can tell whether these are being

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meaningfully addressed. New standards will also more tightly tie long-term advances solely to housing. Restricting non-IDI member advances unless mortgages and other mission assets – not just MBS – exceed 10% of assets.

Outlook

Despite its sweeping plans, FHFA was still forced to forbear on issues such as resetting Bank executive compensation, but the threat that it will ask Congress for authority to do so must be striking fear in the System's corner offices. Or it would if CEOs and other insiders are able to look past the imminent threat that FHFA will press the weaker Banks to consolidate, using its statutory authority to press the Banks to move from eleven charters to eight (fewer than that would take new law). A lengthy discussion of operational realignment to increased shared services might pull some of the weaker Banks off the brink, but it seems unlikely that the fractious System with many built-in competitive rivalries over the largest IDI members will work and play well enough to allow weaker Banks to develop alternative revenue sources as non-traditional members curtail advances, the Banks raise capital and institute new controls, more mission-adherence comes at cost, and outstanding emergency-liquidity advances mature with less opportunity for weaker IDIs to renew them.

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