GSE Activity Report

Tuesday, March 12, 2024

FHLBs Forced Into an Unflattering Limelight

Summary

The President's FY25 budget picks up FHFA's recommendations, calling for statutory change to double the System's affordable-housing commitment. That won't happen anytime soon, but a new CBO report strengthens FHFA's hand in several areas well within its jurisdiction.

Impact

CBO takes no stand on whether the FHLBs are worth their subsidy, although it concludes that they might reduce housing costs and enhance member liquidity. Still, its data show that this comes at a cost of 2024 of about $7 billion, offset by $350 million in affordable-housing contributions. The subsidy – stoutly denied by FHLB advocates – comes largely from the implied guarantee, which gives the Banks an AAA rating despite the A to BBB their actual finances would warrant without their GSE status. And, as CBO notes, exemption from taxation also helps more than a bit.

"Almost all" of the net subsidy passes through to members who enjoy dividends and may or may not use funding to promote the FHLB mortgage-finance mission. As the CBO notes, FHLB funding is fungible and thus can be used as each member desires.

The paper also concludes that FHLB taxpayer risk is not zero, but also not much despite continuing concentration in large borrowers and possible rollover risk. Even were the worst to come true, the paper of course references the super-lien that gives the Banks claim ahead of any other creditor of a failed member. Given that MetLife is among the System's biggest borrowers and other insurers also make ample use of it, it's at best unclear how this would work in an insurance-guarantee association resolution. However, FHLB over-collateralization requirements for insurance members likely leaves less for the guarantor. Insurance companies make up just 4% of System borrowers but account for one-sixth of advances.

Outlook

What is clear is that the Banks swoop in ahead of the FDIC, not only when it comes to the super-line, but also to record early-repayment penalties revealed today by *Bloomberg*. The CBO study assesses this in largely quantitative terms without adjudging the super lien's benefits.

We don't expect this silence to last. Last year, the FDIC suffered higher losses thanks to the super-lien and Signature Bank failed in part because the bank couldn't tell which collateral was pledged to the System and how much was unencumbered and thus suitable for discount-window advances. The banking agencies are working hard on new liquidity regulations designed to ensure discount-window readiness. These rules are likely to force banks to keep far better track of collateral and ensure that they have enough of it unencumbered by System demands to ensure ready draws from the Fed to

Federal Financial Analytics, Inc.
2101 L Street, N.W., Suite 300, Washington, D.C. 20037
Phone (202) 589-0880
E-mail : info@fedfin.com www.fedfin.com

stave off liquidity shocks. That will leave less for the System and thus curtail the advance use now running high thanks to smaller-bank deposit shortages and the end of the Bank Term Funding Program.

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Phone (202) 589-0880
E-mail : info@fedfin.com www.fedfin.com