



JUNE 29, 2010 | Vol. 1, No. 2

Was this forwarded to you? [Click here](#) to receive it directly.

FROM THE EDITOR

Welcome To ABA's Federal Home Loan Bank Member Insights

Welcome to the second edition of ABA's Federal Home Loan Bank Member Insights – our publication for and about the Federal Home Loan Banks and their members.

It is a busy time in Washington, with momentous decisions being made about the future of the entire banking industry, including the Federal Home Loan Banks.

In this issue we will focus on the latest updates on proposed legislation to dramatically alter financial regulation and the impact on the Home Loan Bank System.

We will also bring you insights on the collateral policies of the Federal Home Loan Banks in an article from Kirk Malmberg, the Executive Vice President and Chief Credit Officer at the Federal Home Loan Bank of Atlanta.

And, last but not least, we cover in more detail an honor mentioned in the last issue – the award presented to the FHLB Systems' Affordable Housing Program by the National Housing Conference.

As always, we want this publication to reflect the interests and concerns of our Federal Home Loan Bank members. With that in mind, please feel free to contact me with ideas for stories, questions, complaints or compliments or anything else of interest. You can reach me at JPigg@aba.com.

WASHINGTON UPDATE

Progress Made on Federal Home Loan Bank Issues in Regulatory Restructuring Legislation

The House/Senate conference on regulatory restructuring legislation finished its work early on the morning of Friday, June 25th. The conference dealt with a number of issues important to Federal Home Loan Banks and their members. These issues have been largely resolved favorably for the FHLBs. That said, however, the overall bill is much more negative than positive for the overall banking industry, and ABA strongly opposes the bill.

Conferees adopted language exempting the Federal Home Loan Banks from the definition of “systemically important” for purposes of imposing concentration limits on the Banks. ABA joined the Council of Federal Home Loan Banks to oppose a provision in the regulatory reform bill that would force many banks to reduce their Federal Home Loan Bank advance positions. The provision would have prohibited institutions deemed systemically important from lending an amount to any unaffiliated company that exceeded 25 percent of the Federal Home Loan Bank's capital stock and surplus.

Ultimately the conferees agreed to exempt the FHLBs from the provision.

Another important issue for the Federal Home Loan Banks was the inclusion of the Federal Home Loan Banks in a provision of the conference bill offered by Senator Susan Collins (R-ME) relating to capital. The Collins amendment would have erased all trust preferred securities from their 1 capital calculations, and would have excluded FHLB stock from the definition of system capital if FHLBs were deemed systemically important. Some improvements were made to the Collins provisions, including grandfathering the trust preferred securities held as capital by banks under \$15 billion in assets. Specifically with regard to the Federal Home Loan Banks, the conferees have agreed to exempt the FHLBs from coverage under the Collins provision, recognizing that the stock based borrowing requirements of the System do not fit within the tier 1 capital requirements of the Collins provision.

Another key area of concern for the Federal Home Loan Bank was the coverage of the Federal Home Loan Banks under the Volker Rule provisions of the bill. The Volker Rule provisions as originally proposed would bar proprietary trading by insured depository institutions and bank holding companies and their subsidiaries, as well as provisions imposing additional capital requirements and quantitative limits for nonbank financial companies that engage in proprietary trading. In both instances, the draft bill contained specific exemptions from these limitations for trading in obligations, participations, or other instruments of Ginnie Mae, Fannie Mae, and Freddie Mac. However, the bill did not add the FHLBs to this list of agencies whose obligations were excluded. ABA opposed the Volker Rule as proposed, including an exemption for the Federal Home Loan Banks. Some progress was made to improve the language, including an exemption for the Federal Home Loan Banks.

ABA and the Federal Home Loan Banks argued that FHLB securities should be given the same treatment as other agency securities that are specifically excluded from the “Volcker Rule” limits on proprietary trading, consistent with the way in which the agency debt markets operate. The agency debt markets function in a manner that does not give separate treatment for different agency debt. Failure to give FHLB securities the same statutory exclusion could cause unnecessary confusion in these markets, and could have the unintended effect of adversely affecting the valuations of FHLB securities as well as the FHLBs’ cost of funding.

It is expected that the conference bill will be taken up in the House as early as Tuesday and that the Senate may follow suit soon after. Congressional leaders and the Obama Administration are attempting to present a final conference bill to the President prior to July 4th. ABA’s Newsbytes provides daily updates on the progress of the legislation. To subscribe, email the editor at Newsbytes@aba.com.

INSIGHT

Federal Home Loan Bank Collateral Policies – Perspectives From The Atlanta Bank



By Kirk R. Malmberg
EVP and Chief Credit Officer
FHLB of Atlanta

Current policy debates in Washington, D.C. about the rights and responsibilities that govern secured lenders have generated a broadening awareness about the Federal Home Loan Bank System and its unique relationship with member financial institutions. Many federal home loan bank (FHLB) members that are active borrowers are well aware of how their creditworthiness and eligible loan collateral are critical factors that determine how much advance funding they can use for A/L management or access for contingent liquidity purposes.

However, efforts by individual FHLBs to enhance overall risk management and to create a more dynamic framework for evaluating creditworthiness and collateral values are driving many credit and collateral policy changes, which in turn have prompted active borrowers as well as occasional borrowers to take a closer look at the impact these changes will have on their business. Given the depth and breadth of these changes, I think it would helpful to provide ABA members with an overview of trends and developments that are

influencing and informing them.

A bedrock element of the federal home loan bank system is its ability to secure wholesale loans, or advances, by placing liens against collateral assets, most commonly one-to-four family residential mortgages or cash and securities. In this capacity, the FHLBs have not changed a great deal from when they were created during the Great Depression in 1932. The confidence of ensuring that borrowings are secured by collateral was the main driver of why the system was the “first-responder” when many institutions sought funding sources during the liquidity crunch of 2008.

Collateral and Advances

Had the FHLBs not had this security it would have been severely limited in executing its mission. In that event, a bad situation may have been far worse without the nearly \$500 billion in FHLB liquidity that supported borrowers of all sizes and charter types in 2008-2009. The secured lending position also is the fundamental reason why the FHLBs have never experienced a credit loss on an advance.

This underlying principle of secured lending has not changed in many decades, though its application has evolved significantly. That is because in recent years members increasingly sought to pledge as collateral residential mortgage loans with a range of features that affect their underlying value, performance, and cash flows. Also, as we know, residential property values have fluctuated widely based on region, location, and loan type.

This major change in the composition and, in many cases, the quality and performance of the mortgage collateral pool, forced FHLBs to develop more finely-tuned collateral policies and valuation practices so they can continue to execute their mission while operating safely and soundly and within the limits of evolving regulatory standards.

In some instances, the FHLBs must establish policies that mirror those of the primary safety and soundness regulators of our membership. A key example of this is FHLB requirements and limitations related to nontraditional and subprime mortgages. At the Federal Home Loan Bank of Atlanta, we recently imposed limitations on how much a member may pledge of these loan types as eligible collateral.

This policy change is shaped in large part by the inter-agency regulations on nontraditional and subprime loans that were promulgated in 2007. The FHLBs are also required to incorporate these standards into the collateral we accept, so we work closely with members to help them understand the impact on eligible collateral and available funding. To comply, the FHLBs increasingly are requiring members to provide loan-level data on the collateral they use to support advances. For active borrowers, this means a specific pledge of loans. From a member’s perspective, the benefit of providing a specific listing in lieu of a blanket security pledge is that, in some instances, the discount may be lower for a blanket lien. The benefit to the FHLB is that the additional information can provide for a more precise valuation.

Increased submissions of loan-level data require a focus on IT systems, internal processes, and more dynamic interaction with your federal home loans bank, however, there are benefits. In particular, the additional data from the member allows the federal home loan bank to provide a market value that might be more favorable than a traditional collateral discount, or “haircut.” Assessing collateral on a market basis also may provide benefits to members in areas of the country where housing values did not drop as much in recent years or where the housing market is beginning to rebound.

Changes in Creditworthiness

Changes in the financial performance and business strategies of the membership base also prompted closer and more frequent credit reviews by federal home loan banks. As economic growth took hold several years back, members sought to expand their availability of wholesale credit to support contingent liquidity plans, asset-liability management, or accelerating loan demand. The drivers were clear as advances and access to liquidity presented members with a very valuable and flexible tool to manage funding.

However, as members' performance and the economy as a whole faltered, FHLBs have had to engage in more in-depth discussions with institutions to better understand their creditworthiness, independent of how much overcollateralization supports an institution's advances. As a means to protect members' invested capital that totals \$58 billion, credit and risk managers have established robust and dynamic credit models to gauge creditworthiness of members and forecast whether an institution has the potential to default on their advances or fail.

The purpose of this work is clear: protect the FHLB and its mission as well as the member's invested capital. Such rigor is critical in the current environment in which 180 FHLB members with more than \$24 billion in advances have failed since Jan. 1, 2009. The Federal Deposit Insurance Corp. has been engaged in most of these failures and must work closely with the specific FHLB to either pay off advances or transition them to an acquiring institution.

However, the FHLB must operate on the assumption that it may need to own and liquidate collateral pledged to support outstanding advances. This assumption underpins the prudent and conservative positions FHLBs may take with respect to the delivery of collateral files and additional discounts that factor in liquidation costs.

FHLB Lending In the Future

In the past year, FHLB members have paid down advances significantly following the ramp up in lending amid the financial crisis. Outstanding advances have decreased from \$1.2 trillion to less than \$700 billion, a contraction that is expected as overall liquidity has increased and loan demand remains weak. However, advances still represent a low-cost funding tool for members positioning balance sheets for rising rates or to fund new assets. That means that credit analysis and collateral valuation as it relates to their relationship with an FHLB will remain a central part of many ABA members' operations and strategic funding options.

NEWS

“Housing’s New Era” is Launched as FHLBs’ AHP is Honored in DC

Twenty years ago, the country's Federal Home Loan Banks conducted the first funding rounds in a program created by Congress to make housing more affordable for a broader spectrum of Americans.

Since those first Affordable Housing Program (AHP) awards, thousands of ABA and FHLB members, project sponsors, and more than one-half million individuals and families have experienced the rewards of sponsoring, funding, creating, renting or owning affordable housing – providing fresh hope to seniors, the homeless, the disabled, first-time homeowners and others of limited means.

On June 9 at the National Building Museum in Washington, D.C., the National Housing Conference (NHC), the nation's preeminent voice for housing, honored the Home Loan Banks as “Housing Partner of the Year” before a crowd of 800 public, private, and nonprofit partners.

System-wide, AHP has created more than 670,000 units of affordable housing over the past 20 years through combined funding totaling nearly \$4 billion – the largest source of private grant funds for affordable housing in the country.

“NHC has emerged as the united voice for housing in Washington,” observed John Bendel of FHLB Pittsburgh, an event attendee and one of twelve community investment directors charged with administering AHP at the regional level. “The event highlighted a very positive message about the mission, value and success of the FHLB. This is always important, but especially now with all the policy discussion around the financial sector,” Bendel said.

As Chief Operating Officer & Sr. EVP Diane Casey-Landry and others from ABA looked on alongside numerous ABA/FHLBs members, the new president and CEO of the National Housing Conference, Maureen

Friar, described her organization's immediate mission: prevent foreclosures, stabilize neighborhoods, help working families meet their housing needs, strengthen the housing finance system, and connect housing, transportation and energy policies. "It is now our job – collectively – to envision a future," Friar said, "... and fight for housing to always remain high on the national agenda."



Speaking for the award recipients, Lee Gibson, Chairman of the Council of Federal Home Loan Banks, added that many of the recent shortcomings in the housing market are unacceptable. "We can do better," Gibson challenged the crowd. "We are indeed... entering housing's new era. It will be a time that will require us to rethink and rebuild a new commitment to housing in America."

In a greeting to attendees, Congressman Barney Frank, chairman of the House Financial Services Committee, wrote in part that AHP "has been an important model for us as to how to draw on streams of funding in ways that increase the stock of affordable housing. And it is important to note that this program has been run without scandal, without claims of waste and fraud, and in general without many of the negative attacks that accompany other programs to build this sort of housing. Being funded in the way that it does, it is an excellent example of private-public cooperation."

"This is the message of this entire evening: working together for affordable housing works," summarized Ed DeMarco, Acting Director of the Federal Housing Finance Agency.

Wells Fargo Home Mortgage was honored to serve as the gala sponsor of the 2010 Housing Program of the Year dinner, and Diane Casey-Landry was Vice Chair of the Gala Dinner.

To view a four-minute video on Housing's New Era, visit <http://www.youtube.com/watch?v=VGXy6mvUXcl>.

Free Teleconference on Lower Reverse Mortgage Closing Costs

Join us for an ABA/[MetLife Home Loans](#) teleconference Thursday, July 15, 2010, 2:00-3:00 p.m., Eastern Time, and learn the truth behind common misconceptions regarding reverse mortgages. And hear about

MetLife Home Loan's fixed-rate reverse mortgage — which offers no origination fee and no monthly servicing fee, so you can offer your clients the highest principal limit allowed in a fixed-rate reverse mortgage with lower closing costs. [Register now!](#)

ABA Mortgage Solutions 2009 Benefit Statements

Last month, ABA Mortgage Solutions issued 2009 year-end benefit statements to the more than 1,000 ABA member banks that participate in the secondary-market partnership programs. In 2009, an average active participant saved \$56,000 through these negotiated price benefits. Savings for all participants totaled \$27 million. ABA Mortgage Solutions negotiates partnerships with key mortgage finance players for the benefit of association members. [Learn more about ABA Mortgage Solutions](#). For more information, contact ABA [Jerry Sebold](#) at 202-663-7540.

The ABA's Federal Home Loan Bank Member Insights newsletter is a service of the American Bankers Association. **ABA Members:** To unsubscribe and to manage your subscriptions, please visit [ABA E-Mail Bulletins](#) and check or uncheck the appropriate boxes. If you have questions or comments on Federal Home Loan Bank issues, please contact ABA Vice President and Sr. Counsel, Joseph Pigg at JPigg@aba.com.

American Bankers Association, 1120 Connecticut Avenue, NW, Washington DC 20036