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## FROM THE EDITOR

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It's August and Congress is in recess until after Labor Day, so things have slowed considerably in Washington. That does not, however, mean that important events are not taking place. In this issue of ABA's Federal Home Loan Bank Member Insights, we bring you news of discussions on the future of housing finance, and the news that at least one member of Congress thinks the future of the Federal Home Loan Banks should include a mandate for more small business lending. If there are issues or events you would like to see covered in ABA FHLB Member INSIGHTS, or if you'd like to comment on an article or item, please email ABA Vice President and Sr. Counsel, Joseph Pigg at [JPigg@aba.com](mailto:JPigg@aba.com).

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## WASHINGTON UPDATE

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### **Obama Administration Holds One Day Forum on the Future of Housing Finance**

On August 17th, the Obama Administration hosted a one day forum on the Future of Housing Finance. The forum, hosted by Treasury Secretary Timothy Geithner and HUD Secretary Shawn Donovan, focused primarily on the future of Fannie Mae and Freddie Mac. ABA was represented at the forum by GSE Policy Committee Chairman Chris Reichert who is the CEO of Stifel Bank and Trust in St. Louis, MO and by Gary Berner, Executive Vice President of First Niagara Bank in Buffalo, NY. The forum is seen as an opportunity to engage in discussion and debate prior to the release of the Administration's plan for dealing with Fannie and Freddie, expected early in 2011. Prior to the forum, ABA filed a comment letter with Treasury and HUD laying out the association's views on questions posed by the Administration on the future of housing finance. While Fannie and Freddie were the main focus of both the forum and the comment letter, the Federal Home Loan Banks will certainly be affected by any policy changes related to Fannie Mae and Freddie Mac. ABA continues to maintain that a first principle in dealing with these government sponsored enterprises is to "first do no harm" to the FHLBs, to ensure that they can continue to meet the liquidity demands of their owner/members in a safe and sound manner. To read ABA's comment letter, [click here](#).

### **Kanjorski Releases GAO Report Critiquing Use of Small Business and Agricultural Collateral by the Federal Home Loan Banks**

On August 11th, Rep. Paul Kanjorski, Chairman of the House Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises, released a report by the Government Accountability Office (GAO) regarding the use of small business and agricultural collateral by the Federal Home Loan Banks.

Kanjorski, along with former Rep. Richard Baker (R-LA), was the author of legislation which expanded the available collateral from Community Financial Institution members of the Federal Home Loan Banks to

include agricultural and small business loans. That legislation passed as part of the Gramm/Leach/Bliley Act in 1999.

In a press release, Kanjorski expressed dissatisfaction with the level of small business and agricultural collateral accepted by the FHLB System to date and indicated that he would introduce legislation to develop a dedicated funding source for small business lending through the Federal Home Loan Banks. To read Kanjorski's press release [click here](#). To read the GAO report, [click here](#)..

ABA believes that it should be left to the member/owners of the FHLB System to determine what forms of collateral best work for them. This is the subject of this month's *INSIGHT* column by ABA's COO Diane Casey Landry which follows this article.

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## INSIGHT

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### **Keep The Federal Home Loan Banks Responsive to the Needs of Their Members By Diane Casey-Landry, ABA Chief Operating Officer**

Recently, the GAO reported that small business and agricultural collateral backs only a small percentage of the advances made by the Federal Home Loan Banks. The finding was no surprise to anyone who follows the Federal Home Loan Bank System closely.

The FHLBanks' main mission continues to be focused on providing liquidity to their member banks in return for mostly residential mortgage collateral. The fact that the Federal Home Loan Banks performed exactly as intended and kept liquidity available during the recent financial crisis is testament to the value and efficacy of the System. New categories of small business and agricultural collateral have added to the FHLBanks' ability to meet their members' needs, but the focus of the System - and many of their members - remains on liquidity for mortgage lending. Yet some policymakers including Rep. Paul Kanjorski, are misinterpreting the findings of the GAO report and heading off in the wrong policy direction.

Rep. Kanjorski, who chairs the Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises, was, along with former Rep. Richard Baker, the sponsor of the effort to expand Federal Home Loan Bank collateral to include small business and agricultural loans. ABA recognizes that the member/owner banks of the Federal Home Loan Bank System should have options to support the broad spectrum of lending requested by their customers, including small business and agricultural collateral.

Contrary to the views espoused by Rep. Kanjorski, ABA strongly believes the advance programs offered by the Federal Home Loan Banks - and the types of collateral accepted by the FHLBanks, should be driven by the member/owners of the Banks, not by Congress or the regulators.

While some of the Federal Home Loan Banks do not accept small business and agricultural collateral, the reason is the lack of demand for the use of such collateral among their members. Other FHLBanks accept these forms of collateral with haircuts that can be significantly steeper than those applied to mortgage loans. Yet, based on member need, several of the Banks have implemented useful and popular programs involving small business and agricultural lending.

Higher haircuts for non-mortgage loans are understandable, given the long history and expertise in the System with mortgage loan valuations. One area where the ABA believes that the Federal Housing Finance Agency (FHFA) could improve is in quantifying the haircuts imposed by the individual Home Loan Banks on

the collateral they accept.

While it must be the decision of the members/owners of the Banks to decide which forms of collateral best meet their needs, it is the responsibility of the FHFA to ensure that the valuations placed on that collateral are reasonable and appropriate for safety and soundness. Some of the FHLBanks have indicated that they would like to reduce the haircuts they take on small business and ag loans, but have been prevented from doing so by the FHFA. Where experience shows that haircuts can be lowered (and many member banks can demonstrate low default rates on both ag and small business loans), then reducing the haircut is a reasonable decision. ABA is pleased that FHFA has responded to the GAO report indicating that it will do more in this area.

Unfortunately, Rep. Kanjorski has indicated that he will introduce legislation to establish a devoted source of funding through the Federal Home Loan Banks for small business loans. This would fundamentally change the System – and potentially imperil its ability to respond to the needs of its member/owners.

It is important to remember that member banks can use advances from the System to fund loans of any kind – small business, agriculture, commercial development, mortgage, and more. Advance money is fungible. And as long as there is sufficient collateral to get more advances, the System works. Requiring the FHLBanks (and their members) to make a certain amount of loans to a certain segment of the market reduces the flexibility of the System and risks repeating a dangerous mistake made with other GSEs in the recent past. When Fannie Mae and Freddie Mac were required to “lead the market” toward more and more lending with limited underwriting and lower or no down-payments, the result was catastrophic. Mandating support for a segment of the market without regard to safety and soundness and strong underwriting was a mistake that should not be repeated.

Loans to small business and agriculture can and should be supported through Federal Home Loan Bank advances, but they should not be mandated. The lack of liquidity is not what is preventing those loans from being made, rather the fact that some borrowers simply do not have the credit rating and capacity to repay a loan comes into play.

More small business and agricultural lending is desirable and achievable. ABA and a number of the Federal Home Loan Banks have sought repeatedly to work with the Small Business Administration to achieve rule changes that would allow SBA guaranteed loans the same ability to be pledged to the Federal Home Loan Banks as other federally guaranteed loans. ABA undertook similar efforts with the U.S. Department of Agriculture which have led to a broader category of ag loans being accepted by the Federal Home Loan Banks. Changes like this, and a greater effort by the FHFA to engage with the Banks and their members to more accurately value small business and agricultural collateral, will help. But other issues, like those mentioned above, cannot be ignored.

Meeting the needs of their member/owners, sound underwriting and strong regulation must continue to be at the core of the Home Loan Banks' mission. When the mission of the System was expanded to include support for small business and agricultural lending in Gramm/Leach/Bliley, it was done responsibly - leaving it to the members of the System, with regulatory oversight, to determine what collateral should be accepted by their local Federal Home Loan Bank. It would be a mistake for Congress to now mandate lending to any one category of borrower or to set targets for particular categories of collateral.

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