



Highlights of [GAO-05-489T](#), a testimony to the Committee on Banking, Housing, and Urban Affairs, U.S. Senate

## Why GAO Did This Study

The FHLBank System (FHLBank System or System) is a government-sponsored enterprise (GSE) that consists of 12 Federal Home Loan Banks (FHLBanks) and is cooperatively owned by member financial institutions, typically commercial banks and thrifts. The primary mission of the FHLBank System is to promote housing and community development generally by making loans, also known as advances, to member financial institutions. To minimize the potential for significant financial problems, the Federal Housing Finance Board (FHFB) regulates the FHLBank System's safety and soundness. Over time, a number of developments have affected the System's safety and soundness and have created pressures on its traditional cooperative structure.

To assist the committee in understanding the important issues surrounding the FHLBank System and its regulation, this testimony provides information on the development of the System; two legislative changes and FHFB rulemaking that led to changes in membership, asset composition, and capital structure; and important challenges and questions the FHLBank System currently faces.

[www.gao.gov/cgi-bin/getrpt?GAO-05-489T](http://www.gao.gov/cgi-bin/getrpt?GAO-05-489T).

To view the full product, including the scope and methodology, click on the link above. For more information, contact Thomas J. McCool at (202) 512-8678 or [mccoolt@gao.gov](mailto:mccoolt@gao.gov).

# FEDERAL HOME LOAN BANK SYSTEM

## An Overview of Changes and Current Issues Affecting the System

### What GAO Found

Established in 1932 to facilitate the extension of mortgage credit, the FHLBank System has undergone significant statutory changes in the last 15 years. Between the 1930s and the 1980s, the System consisted primarily of thrift members that accepted advances from the FHLBanks. However, during the 1980s, hundreds of FHLBank member thrifts failed forcing Congress to fundamentally reform the System through the Financial Institutions Recovery, Reform, and Enforcement Act of 1989 (FIRREA). For example, FIRREA permitted commercial banks to join the System. Although FIRREA is credited with strengthening the thrift industry and the System, concerns were raised during the 1990s about the System's capital structure. In particular, commercial bank members could remove stock from their FHLBank on 6-months notice, which raised concerns about the System's financial stability. Among other provisions, the Gramm-Leach-Bliley Act (GLBA) of 1999 created a more permanent and risk-based capital structure for the System.

Due to these statutes and FHFB rulemaking, the FHLBank System has evolved substantially since 1990. For example, commercial banks now account for more than 70 percent of all System members. The composition of FHLBank System assets has also fluctuated considerably over the years. For example, FHFB authorized the FHLBanks to purchase mortgages directly from their members in the 1990s. The System's mortgage assets grew to about \$113 billion at yearend 2003 representing about 14 percent of total assets. However, the rapid growth in System mortgage assets leveled off in 2004 as two FHLBanks experienced problems managing the interest-rate risks associated with holding mortgages on their books. As provided by GLBA, System capital is now more permanent as members generally must invest capital for a period of 5 years and the FHLBanks are subject to new leverage and risk-based capital requirements.

The FHLBank System faces important challenges and questions going forward. For example, FHFB has called the FHLBanks' risk-management practices into question, particularly those related to mortgage purchase programs. Further, proposals to permit the FHLBanks to issue mortgage-backed securities (securitization) could help ensure the growth of the mortgage purchase business and improve risk management, however these proposals raise questions regarding the FHLBanks' capacity to manage the related risks. Additionally, there is limited empirical information available regarding the extent to which the System is fulfilling its housing and community mission. Finally, questions have been raised regarding the potential negative affects that large financial institutions may have on the traditional cooperative structure of the FHLBank System and its programs designed to benefit targeted groups.