



FEDERAL HOME LOAN BANK
of ATLANTA

RAYMOND R. CHRISTMAN
President and Chief Executive Officer

February 6, 2003

Honorable John T. Korsmo, Chairman
Franz S. Leichter, Director
Allan I. Mendelowitz, Director
J. Timothy O'Neill, Director
John C. Weicher, Director
Federal Housing Finance Board
1777 F Street, N.W.
Washington, D.C. 20006

Dear Directors:

The Federal Home Loan Bank of Atlanta ("Bank") appreciates the opportunity to provide comments in response to the request of the Federal Housing Finance Board ("Finance Board") that the Federal Home Loan Banks ("FHLBanks") identify specific concerns, if any, arising from the ongoing changes in the financial services industry comprising the membership of the FHLBanks and suggest appropriate supervisory or regulatory responses from the Finance Board.

In its resolution requesting comment, the Finance Board notes that recent changes in the financial services industry have affected the distribution of members and membership assets among the FHLBanks, and that such changes may affect the distribution of capital and advance business, the concentration of assets, and the regional availability of Affordable Housing Program ("AHP") funds.

The changes noted above have caused the Finance Board to consider whether it should take regulatory action to modify the terms of membership in the FHLBanks; specifically, whether it should authorize institutions to obtain membership in more than one FHLBank.

The Bank does not believe that these perceived changes in the financial services industry require any supervisory or regulatory response from the Finance Board. Indeed, the Bank believes that such changes simply reflect a natural evolution of the financial markets, rather than a "problem" that requires a "solution" imposed by the Finance Board. In the event that additional changes in the financial services industry should result in a real rather than a perceived problem, the explicit provisions of the Federal Home Loan Bank Act (the "Act") provide the Finance Board with adequate options for addressing such a problem.

The impact on FHLBank membership of each of the changes cited in the Finance Board's resolution is addressed below.

Concentration of Assets Is Not a Problem

The mission of the FHLBanks is to provide funds to support their members' activity in housing and community development lending. This mission applies to members of any size – whether large or small. In fact, Section 7(j) of the Act (12 U.S.C. 1427(j)), requires each FHLBank's Board of Directors to

“administer the affairs of the bank fairly and impartially and without discrimination in favor of or against any member, and ... extend to each institution authorized to secure advances such advances as may be made safely and reasonably with due regard for the claims and demands of other institutions, and with due regard to the maintenance of adequate credit standing for the Federal Home Loan Bank and its obligations.”

Thus, extending large amounts of advances to particular members, so long as it may be done safely and reasonably, is consistent with the mission of the FHLBanks.

While concentration of an FHLBank's advances to one or a few members may be *perceived* to be a problem, we believe that such concentration does not raise the safety and soundness concerns that might be raised by similar concentration in a commercial bank or other financial institution. This is because, unlike borrowers from ordinary financial institutions, an FHLBank's borrowers are federally insured financial institutions, subject to federal or state regulation and examination. In addition, all FHLBank advances must be fully secured by specified categories of member assets, and each FHLBank has a statutory priority lien on the assets pledged to it. Most FHLBanks take additional steps to perfect their liens on collateral by either filing or possession. Therefore, the position of an FHLBank with advances secured by mortgages or other eligible assets may be compared favorably to the position of a purchaser of those same assets at a discount to their market value. The low risk weighting assigned to secured advances under the Finance Board's regulations is consistent with this view.

Dividing the large advances positions of particular members between two or more FHLBanks would not decrease the credit risk to each of those FHLBanks. As noted above, the low risk weighting assigned to secured advances is based substantially on the types and amounts of collateral pledged to secure FHLBank advances, rather than on the creditworthiness of a particular member. Dividing this collateral between two or more FHLBanks could, in fact, increase the risk to each, particularly if collateral assigned to each FHLBank consisted of mortgages originated in one geographic area. In any event, dividing a member's advances and collateral between two or more FHLBanks would not reduce the exposure of the FHLBank System to a particular borrower, particularly in a System in which each FHLBank is jointly and severally liable for the obligations of the others. Instead, the appropriate way to address any perceived concerns regarding concentration is through careful and thorough credit analysis and collateral management.

Distribution of Capital and Advances Is Not a Problem

The Act contemplates that capital and advances may not be distributed evenly among the FHLBanks. This is obviously the case, as capital ranged from approximately \$1.6 billion at the Topeka FHLBank to approximately \$5.9 billion at the San Francisco FHLBank; and advances ranged from approximately \$21.4 billion at the Seattle FHLBank to approximately \$86.0 billion at the San Francisco FHLBank (at September 30, 2002). Broad differences in distribution among the FHLBanks in both the amounts of capital and advances have existed throughout the history of the FHLBank System. Such differences are to be expected in a system that was created along geographic boundaries to provide an ongoing source of funds for housing finance and economic development throughout various market cycles. Thus a change in the distribution of capital and advances among the FHLBanks does not signal a safety and soundness concern that should (or even may) be addressed by a Finance Board regulation permitting multi-district membership.

Instead, the explicit provisions of the Act itself provide the Finance Board with adequate options for addressing such an issue, should it become a problem. For example, Section 3 of the Act (12 U.S.C. 1423) permits the Finance Board to readjust FHLBank districts or to create new districts from time to time. The Finance Board's predecessor, the Federal Home Loan Bank Board, utilized this authority on a number of occasions. Further, Section 26 of the Act (12 U.S.C. 1446) authorizes the Finance Board to liquidate or reorganize an FHLBank. There is nothing in the statute that suggests the Finance Board should, instead (in contravention of the explicit provisions regarding membership), use its safety and soundness authority to permit or require institutions to become members of multiple FHLBank districts in order to more evenly distribute capital and advances throughout the FHLBank System.

Perceived Inequities in the Regional Availability of AHP Funds May Be Resolved by Methods Other Than Multi-District Membership

Similarly, there is nothing in the statute or regulations that suggests that AHP funds should be distributed evenly throughout the FHLBank System. On the contrary, the statute provides that each FHLBank shall contribute annually to its AHP the greater of 10% of its net earnings for the previous year, or its pro rata share (based on its net earnings for the previous year) of an aggregate of \$100 million to be contributed by all of the FHLBanks. Given the differences in capital and assets of each of the FHLBanks, it is not surprising that differences exist in the net earnings, and consequently the AHP contributions, of each FHLBank as well.

We understand that all but one of the FHLBanks currently permit the award of AHP funds to support projects outside of the relevant FHLBank district. To the extent that the Finance Board is concerned about the regional availability of AHP funds, it could require all FHLBanks to adopt such a policy. While some FHLBanks impose limits on the amount of AHP funds that may be awarded to a single member, these limits do not prohibit a member from funding out of district projects. If the Finance Board is concerned about such limits, it could permit the FHLBanks to link the availability of AHP funds to use of an FHLBank's products and services. There are many options available to the Finance Board, short of authorizing multi-district membership, to address perceived inequities in the distribution of AHP funds.

Other Issues Associated with Multi-District Membership

Legal Ambiguity and Operational Issues

While we believe that the Finance Board's authority to authorize multi-district membership is questionable, we also believe that sufficient arguments in that regard are already contained in the official record on this topic. Therefore, we do not intend to repeat those arguments here. However, we urge the Finance Board to consider carefully not only its legal authority to permit unfettered multi-district membership, but also the operational issues that are likely to arise as a result of such action, including but not limited to: intercreditor relationships; allocation of advances; allocation of collateral; allocation of stock requirements; voting and director representation; AHP competition issues; antitrust issues; and issues regarding sharing, tracking and reporting relevant information. We provided extensive comments on these issues in our response to the Finance Board's previous solicitation of comments on multi-district membership.¹ We again emphasize that the operational issues associated with multi-district membership are extremely complex and challenging.

FHLBank Competition

While certain institutions affiliated in a holding company structure may be members of different FHLBank districts today, the regulatory, accounting and logistical difficulties associated with inter-affiliate transfers of funds and related capital and collateral assets limits the competition among FHLBanks with respect to these members. Conversely, we believe that the competition resulting from true multi-district membership would create a potential for serious harm to the FHLBanks, which are all part of a cooperative system with joint and several liability.

Because the FHLBanks generally obtain their funds from the same source, their funding costs are likely to converge over time, limiting their ability to compete effectively on product pricing. Therefore, they will be left to compete for member business on credit and collateral terms; and the FHLBanks with the most liberal credit and collateral policies will be likely to attract the most business. Of course, these are the very policies that will present the most risk to the FHLBank System, particularly to those FHLBanks with more restrictive policies that have lost the race for member business, but which will nevertheless remain jointly and severally liable for the debt of the other FHLBanks. Thus, the increased competition among the FHLBanks resulting from multi-district membership could create a potential threat to the long-term viability of the FHLBank System.

FHLBank Advance Participations

The New York and San Francisco FHLBanks have proposed, as an alternative to multi-district membership, a plan for allocating the advances of members engaged in cross-district mergers or branch acquisitions among the affected FHLBanks. Because this suggested approach does not require membership in more than one FHLBank, it avoids the legal authority questions raised by

¹ See "Federal Home Loan Bank of Atlanta Response to Solicitation of Comments on Multiple Federal Home Loan Bank Memberships," filed with the Finance Board under cover of a letter to Ms. Elaine Baker, dated February 28, 2002, incorporated here by reference.

multi-district membership. In addition, because it would permit each FHLBank affected by a cross-district merger to participate in the surviving member's advance activity, it eliminates many of the arguments surrounding concentration and competition among the FHLBanks. While the participations proposal introduces its own set of issues, these issues may be easier to resolve than those associated with multi-district membership.

Conclusion

The history of the FHLBank System is replete with changes in distribution among the FHLBanks in amounts of capital and advances, numbers of members, concentration of assets, etc. The FHLBanks were designed to expand and contract with member activity, and the changes to the FHLBanks' capital structure pursuant to the Gramm-Leach-Bliley Act of 1999 will enable them to do so even more efficiently. No structural changes have occurred in either the FHLBank System or in the financial services industry that would suggest that multi-district membership is either necessary or appropriate to ensure the safety and soundness of the FHLBanks. We urge the Finance Board to refrain from taking regulatory or supervisory action to authorize multi-district membership.

Sincerely,



Raymond R. Christman

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cc: Elaine Baker