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December 9, 2002

PRIVILEGED AND CONFIDENTIAL

John Thomas Korsmo
Chairman
Federal Housing Finance Board
1777 F Street, N.W.
Washington, D.C. 20006

Re: The Federal Housing Finance Board's Authority to Allow Federal Home Loan Banks to Provide Advances, and to Grant Membership, to a Member of Another Federal Home Loan Bank

Dear Chairman Korsmo:

You have requested our opinion on the following question: Given the authority granted to the Federal Housing Finance Board ("Board") by statute and precedent, may the Board permit a Federal Home Loan Bank ("FHL Bank") to extend privileges or services to an eligible institution that is a member of another FHL Bank?

In analyzing this issue, we reviewed the Federal Home Loan Bank Act ("Act"), 12 U.S.C. § 1421 *et. seq.*, selected legislative materials, the original Act and relevant amendments thereto; selected regulatory materials issued by the Board and its predecessor, the Federal Home Loan Bank Board, comments received by the Board on its request for comment on Multiple Federal Home Loan Bank Memberships; and relevant Supreme Court cases. Our analysis of this issue is set forth in the attached memorandum.

We conclude that the Board could, in economic effect, authorize FHL Banks to provide deposit, advance, and other services to institutions that are members of other FHL Banks without providing for multi-district membership. In addition, as described in the attached memorandum, we conclude that, although the matter is not free from doubt, the better view is that the Act authorizes the Board to promulgate a regulation allowing an FHL Bank to grant membership to a member of another FHL Bank, to the extent that the regulation furthers the mandate imposed by Congress on the Board, including that the Board "ensure that" FHL Banks "operate in a financially safe and

sound manner," "carry out their housing finance mission," and "remain adequately capitalized and able to raise funds in the capital markets." 12 U.S.C. §§ 1422a(a)(3)(A), (B)(ii), (iii). In light of Congress' grant of broad authority to the Board "to promulgate and enforce such regulations and orders as are necessary from time to time to carry out the provisions of" the Act, 12 U.S.C. § 1422b(a)(1), a duly promulgated regulation that carries out the Board's statutory mandate should be given substantial deference by the courts.

The principal argument against the Board exercising regulatory authority to allow multi-district memberships is based on the view that the statutory provision setting forth a "[l]ocation requirement," 12 U.S.C. § 1424(b), should be interpreted to limit the Board's authority to authorize membership of an institution in a single FHL Bank. Although the statutory text provides some support for that interpretation, we believe the better view is that, based on the overall text and structure of the statute, Section 1424(b) does not expressly address the issue and is, at most, ambiguous so that a regulation duly promulgated by the Board interpreting the Act to allow multi-district memberships would warrant judicial deference.

This opinion is based on the law and facts as of the date of this opinion. Any change in the law or facts could lead to a different result. This opinion is provided solely for the benefit of you and the members of the Board and may not be relied on by any other person.

Very truly yours,

Morrison & Foerster

Morrison & Foerster LLP

MORRISON & FOERSTER LLP

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M E M O R A N D U M

TO: John T. Korsmo cc: Thomas D. Casey

FROM: Oliver I. Ireland
Beth S. Brinkmann
Veronica K. McGregor

DATE: December 9, 2002

RE: The Federal Housing Finance Board's Authority to Allow Federal Home Loan Banks to Provide Advances, and to Grant Membership, to a Member of Another Federal Home Loan Bank

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INTRODUCTION

You have asked whether the Federal Housing Finance Board ("the Board") is authorized to permit a Federal Home Loan Bank ("FHL Bank") to extend privileges or services to an institution that maintains membership in another FHL Bank. More generally, you have asked whether this authority would include allowing an FHL Bank to grant membership to an institution that is a member of another FHL Bank.

In analyzing this issue, we reviewed: the Federal Home Loan Bank Act ("Act"), 12 U.S.C. § 1421 *et. seq.*, selected legislative materials, the original Act and relevant amendments thereto; selected regulatory materials issued by the Board and its predecessor, the Federal Home Loan Bank Board, comments received by the Board on its request for comment on Multiple Federal Home Loan Bank Memberships; and relevant Supreme Court cases. We conclude that the Board could, in economic effect, authorize FHL Banks to provide deposit, advance, and other services to institutions that are members of other FHL Banks, without providing for multi-district membership. In addition, for the reasons stated herein, we conclude that, although the matter is not free from doubt, the better view is that the Act authorizes the Board to promulgate a regulation allowing an FHL Bank to grant membership to a member of another FHL Bank, to the extent that the regulation furthers the mandate imposed by Congress on the Board, including that the Board "ensure that" the FHL Banks "operate in a financially safe and sound manner," "carry out their housing finance mission," and "remain adequately capitalized and able to raise funds in the capital markets." 12 U.S.C. §§ 1422a(a)(3)(A), (B)(ii), (iii). In light of Congress' grant of broad authority to the Board "to promulgate and enforce such regulations and orders as are necessary from time to time to carry out the provisions of" the Act, 12 U.S.C. § 1422b(a)(1), a duly promulgated regulation that carries out the Board's statutory mandate should be given substantial deference by the courts.

The principal argument against the Board exercising regulatory authority to allow multi-district memberships is based on the view that a statutory provision setting forth a "[l]ocation

requirement," 12 U.S.C. § 1424(b), must be interpreted to limit the Board's authority to authorize membership of an institution in a single FHL Bank. Although the statutory text provides some support for that interpretation, we believe that the better view is that, based on the overall text and structure of the statute, Section 1424(b) does not expressly address the issue and is, at most, ambiguous so that a regulation duly promulgated by the Board interpreting the Act to allow multi-district memberships would warrant judicial deference.[1]

QUESTION PRESENTED

Whether the Board is authorized to permit an FHL Bank to extend privileges or services (including providing advances and granting membership) to an institution that maintains a membership in another FHL Bank.

I. FACTUAL BACKGROUND

A. The Banks

The Federal Home Loan Bank System was created by Congress in 1932 to combat declining home ownership, to place long term funds in the hands of local institutions, and to serve the small saver and homebuyer in cities and small towns.[2] Pursuant to congressionally delegated authority, the Board's predecessor established twelve FHL Banks located in different geographic districts. 12 U.S.C. § 1423.[3] The FHL Banks are privately capitalized, government-sponsored enterprises that help finance the country's urban and rural housing and community development needs.[4] A "member" of an FHL Bank is defined as an institution that has "subscribed for the stock of [an FHL] Bank." 12 U.S.C. § 1422(4). The members of FHL Banks may include commercial banks, savings institutions, credit unions, and insurance companies. To date, each member has belonged to only one of the twelve regional FHL Banks, although there are various affiliated entities that are members of different FHL Banks.

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[1] This memorandum addresses only the issue of membership in, or access to services from, multiple FHL Banks. Issues of qualification for such membership and capital requirements or rating of such institutions are not addressed.

[2] H.R. Rep. No. 72-1418, at 8 (1932).

[3] The Board was created as the successor to the authority of the Federal Home Loan Bank Board "with respect to the Federal Home Loan Banks." 12 U.S.C. § 1422a. References to the "Board" are intended to refer to that predecessor entity where appropriate.

[4] *See* www.fhfb.gov/AboutUs./aboutus.htm.

B. The Board's Authority

The Board is an independent, executive branch agency created by Congress. 12 U.S.C. § 1422a(a)(2). Congress charged the Board with the "primary duty" of "ensur[ing] that the [FHL Banks] operate in a financially safe and sound manner." 12 U.S.C. § 1422a(a)(3)(A).[5] In addition, Congress mandated that, "[t]o the extent consistent with" that primary duty, the Board "shall also" supervise the FHL Banks, and ensure that they "carry out their housing finance mission," and "remain adequately capitalized and able to raise funds in the capital markets." 12 U.S.C. §§ 1422a(a)(3)(B)(i), (ii), (iii).

The Board's express powers also include the authority to readjust the twelve geographic districts from time to time, 12 U.S.C. § 1423, and to dissolve an FHL Bank. *See* 12 U.S.C. § 1446; *Fahey v. O'Melveny & Myers*, 200 F. 2d 420, 461 (9th Cir. 1952) ("Dissolution of a bank is an administrative function which, under express provisions of the Federal Home Loan Bank Act, may only be exercised by the Board."); *id.* at 444 (noting that "Congress has . . . specifically and bluntly reserved to itself and to its administrative agent, the Board, the exclusive power to make effective decisions" regarding the function of the Federal Home Loan Bank System). The Board is vested with authority to: remove directors and officers of an FHL Bank; charge a Bank or an officer or director with engaging in an unsafe or unsound practice in conducting the business of the bank or otherwise violating the governing statutes, regulations, and orders; order that corrective action be taken by such Bank, officer, or director; and act in its own name in enforcing any statutory or regulatory provision. 12 U.S.C. §§ 1422b(a)(2), (5), (7).

Congress expressly vested the Board with the power "to promulgate and enforce such regulations and orders as are necessary from time to time to carry out the provisions of" the Act. 12 U.S.C. § 1422b(a)(1). Pursuant to that authority, the Board has promulgated regulations to implement the statute. *See* 12 C.F.R. pts. 900-997.

II. Legal Framework And Analysis

The Act does not expressly and unequivocally provide for an institution to be a member of more than one FHL Bank at one time. Whether a Board regulation that authorizes an FHL Bank to provide services to, or to grant membership to, a member of another district is upheld against a legal challenge will depend on whether the court finds that the Board's interpretation of the statute, as embodied in the regulation, is entitled to deference. If deference is warranted, the Board will prevail. If the court declines to defer to the Board's interpretation, the Board will lose because the court will have determined either that the statute expressly prohibits such a

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[5] As originally enacted in 1932, the statute did not identify this duty as the Board's "primary duty." Rather, Section 17 of the Federal Home Loan Bank Act, Pub. L. No. 72-304, 47 Stat. 725, 736 (1932), since repealed, provided that "The board shall supervise the Federal Home Loan Banks created by this Act, shall perform other duties specifically prescribed by this Act, and shall have the power to adopt, amend, and require observance of such rules, regulations, and orders as shall be necessary from time to time for carrying out the purposes of the provisions of this Act."

regulation, or that the Board's interpretation is unreasonable. Whether deference is warranted will depend on application of the Supreme Court's rulings in *Chevron U.S.A. Inc. v. Natural Resources Defense Council,* 467 U.S. 837 (1984), and *United States v. Mead Corp.*, 533 U.S. 218 (2001).

A. The Standard for Judicial Deference to an Agency's Regulation

In *Chevron*, the Supreme Court established a two-step test for determining whether judicial deference is due to an agency's interpretation of a statute as set forth in its regulations. A court must first determine "whether Congress has directly spoken to the precise question at issue." *Chevron*, 467 U.S. at 842. "If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress." *Id.* at 842-843 (footnote omitted).

But, if the court "determines Congress has not directly addressed the precise question at issue, the court does not simply impose its own construction on the statute," as it would in the absence of an administrative interpretation. *Id.* at 843 (footnote omitted). Instead, "if the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute." *Id.* The agency's interpretation need not be the only permissible reading of the statute, "or even the reading the court would have reached if the question initially had arisen in a judicial proceeding." *Id.* at 843 n.11 (citations omitted).

Chevron further explained that, if there is an express delegation by Congress to an agency "to elucidate a specific provision of the statute by regulation," such a legislative regulation must be given controlling weight unless it is "arbitrary, capricious, or manifestly contrary to the statute." *Chevron*, 467 U.S. at 844 (footnote omitted). Even if the "legislative delegation to an agency on a particular question is implicit rather than explicit," a court "may not substitute its own construction of a statutory provision for a reasonable interpretation made by the administrator of an agency." *Id.*

More recently, in *Mead*, the Court considered the limits of *Chevron* deference. The Court noted that it had accorded varying degrees of deference to administrative interpretations of federal statutes over the years, depending on various circumstances. The Court explained that, in *Chevron*, it had identified a category of agency interpretations that is due deference if found to be reasonable because Congress, either explicitly or implicitly, has indicated that it "expect[s] the agency to be able to speak with the force of law when it addresses ambiguity in the statute or fills in a space in the enacted law, even one about which 'Congress did not actually have an intent' as to a particular result." *Mead*, 533 U.S. at 229 (citing *Chevron*, 467 U.S. at 845).

The *Mead* Court then held that *Chevron* deference is due only in such cases where Congress has delegated authority to the agency generally to make rules carrying the force of law, and where the particular agency interpretation seeking deference was promulgated "in the exercise of that authority." *Id.* at 226-227. The Court emphasized that Congress' delegation of

such authority "may be shown in a variety of ways," including not only by "an agency's power to engage in adjudication or notice-and-comment rulemaking," but also where there is "some other indication of a comparable congressional intent." *Id.* at 227. The Court specifically noted that it had accorded *Chevron* deference in certain instances where there had been no administrative formality, citing as an example its deference to the interpretations by the Comptroller of the Currency in *NationsBank of N.C., N.A. v. Variable Annuity Life Ins. Co.*, 513 U.S. 251 (1995). *Mead*, 533 U.S. at 231 n.13 (noting longstanding precedent that the Comptroller "is charged with the enforcement of banking laws to an extent that warrants the invocation of [the rule of deference] with respect to his deliberative conclusions as to the meaning of these laws," and that Comptroller is "given 'personal authority' under the National Bank Act") (citations omitted).

Finally, the *Mead* Court explained that, even where an agency interpretation does not warrant *Chevron* deference, it may merit "some" deference under *Skidmore v. Swift & Co.*, 323 U.S. 134, 139 (1944). *Mead*, 533 U.S. at 234. The weight accorded an administrative interpretation under *Skidmore* depends on "the thoroughness evident in its consideration, the validity of its reasoning, its consistency with earlier and later pronouncements, and all those factors which give it power to persuade, if lacking power to control." *Skidmore*, 323 U.S. at 140.[6]

B. There is a Reasonable Argument That a Board Regulation Authorizing an FHL Bank to Provide Advances, and to Grant Membership, to a Member of Another FHL Bank Would be Entitled to *Chevron* Deference

1. Notice-and-Comment Rulemaking Authority

It appears clear from the text and structure of the Act that Congress expected the Board "to speak with the force of law when it addresses ambiguity in the statute or fills in a space in the enacted law, even one about which 'Congress did not actually have an intent' as to a particular result," as set forth in *Mead*. 533 U.S. at 229 (citing *Chevron*, 467 U.S. at 845). As noted above, Congress expressly mandated that the Board, as its primary duty, "ensure" that the FHL Banks "operate in a financially safe and sound manner" and, to the extent consistent with that duty, "supervise" the FHL Banks, "ensure" that the FHL Banks "carry out their housing finance mission" and "remain adequately capitalized and able to raise funds in the capital markets." 12 U.S.C. §§ 1422a(a)(3)(A), (B)(i), (ii), (iii). Furthermore, Congress expressly vested the Board with the authority to promulgate regulations, carrying the force of law, and to enforce such regulations as are necessary to implement the Act. 12 U.S.C. § 1422b(a)(1). That authority

[6] Justice Scalia was the lone dissenter in *Mead*. He views *Chevron* as having displaced *Skidmore* altogether. The majority characterized Justice Scalia's position as being an "either-or" choice--either an agency interpretation merits *Chevron* deference or none at all--depending on whether the challenged interpretation is an "official" position of "central agency management." *Mead*, 533 U.S. at 237, 238 n.19. The majority described its own approach as "tailor[ing] deference" to the "variety" of administrative schemes. *Id.* at 236.

necessarily extends to regulations promulgated pursuant to the Board's "primary" and other statutory duties.

In order to provide the best grounds for claiming deference under *Mead*, any effort by the Board to authorize an FHL Bank to make advances, and to grant membership, to a member of another district should be undertaken pursuant to the Board's express statutory authority to promulgate regulations implementing the Act. The Board's promulgation of the regulation should conform with the requirements of Section 553 of the Administrative Procedures Act, including publication in the Federal Register of a notice of a proposed rule and provision of an opportunity for interested persons to submit comments. 5 U.S.C. §§ 553(b) and (c).

As part of that process, the Board should set forth in the introductory remarks accompanying any notice of proposed rulemaking or final rule, the basis for its interpretation of the statute as authorizing it to promulgate such a regulation. To the extent the overall text and structure of the statute support the Board's interpretation, that analysis should be stated expressly. Also, to the extent the regulation is in furtherance of the Board's primary duty to ensure the financial safety and soundness of the FHL Banks, it should so state. The Board's authority concerning an FHL Bank's provision of services or grant of membership to a member of another district would be strongest if such action were in furtherance of that primary duty. The Board should discuss specifically how allowing an FHL Bank to provide services to a member of another district or allowing multi-district membership furthers the stated economic purposes of the Act, such as operating in a financially safe and sound manner. The Board also should discuss any potential adverse effects that multi-district membership may have on the stated purpose of the rule and why those effects are mitigated or outweighed by other factors. The rationale provided by an agency to justify its regulation has long been cited as a factor for courts to consider when determining whether to grant deference under *Skidmore*.

Similarly, the Board should carefully address and respond to any public comments it may receive regarding the authority of the Board to promulgate a regulation permitting FHL Banks to provide deposit, advance, and other services or multi-district membership to institutions that are members of other FHL Banks. A persuasive and reasoned response to any claim that the Board lacks authority to issue the regulation will also strengthen the likelihood that the Board's statutory construction will be given deference.

Such a duly promulgated regulation, supported by persuasive legal arguments set forth by the agency, will have the best chance of being granted *Chevron* deference according to *Mead*. The validity of such a regulation should merit *Chevron* deference and should be upheld as a reasonable interpretation of the statute, unless a court is convinced that the statute unambiguously prohibits such a regulation.[7]

[7] The Board also is expressly authorized by statute to enforce such "orders" as are necessary to carry out the provisions of the statute. 12 U.S.C. § 1422b(a)(1). Thus, the Board may also be able to use its adjudicatory authority to authorize multi-district membership, but the *Mead* and *Chevron* doctrine suggests that rulemaking may prove to be a more reliable method.

2. The Board's Authority to Allow an FHL Bank to Provide Services to a Member of a Different FHL Bank

The Act expressly allows FHL Banks to accept deposits by members of any other FHL Bank, 12 U.S.C. § 1431(e)(1), to rediscount notes held by other FHL Banks and to require such rediscounts, 12 U.S.C. § 1431(f), and to sell advances made to members to other FHL Banks. 12 U.S.C. § 1430(d). In 2000, the Board promulgated a regulation that allows an FHL Bank to become a creditor to a member of another FHL Bank "through the purchase of an outstanding advance, or a participation interest therein, from the other Bank, or through an arrangement with the other Bank that provides for the establishment of such a creditor/debtor relationship at the time an advance is made." 12 C.F.R. § 950.25(a). The regulation further states that any creditor/debtor relationship established in that manner "shall be subject to all of the provisions of this part that would apply to an advance made by a Bank to its own members or housing associates." 12 C.F.R. § 950.25(b). Under Board regulations, FHL Banks also provide unsecured extensions of credit to a variety of counterparties, including members of other FHL Banks and institutions that are not members of FHL Banks. These extensions of credit include overnight federal funds sales, as well as longer term transactions. *See, e.g.*, 12 C.F.R. § 932.9 (establishing limits on unsecured extensions of credit to counterparties). We understand that as of the end of 2001, FHL Banks had over $90 billion in unsecured credit exposure, Federal Housing Finance Board, *Profile of the Federal Home Loan Bank System, December 31, 2001*, at 11, including significant exposure to members at other FHL Banks. 66 Fed. Reg. 50,366, 50,370 (Oct. 3, 2001).

Thus, the Act allows FHL Banks to provide some services, such as acceptance of deposits, directly to members of other FHL Banks. In other cases, such as advances, the Act does not authorize direct secured advances to nonmembers, *see* 12 U.S.C. § 1430(a), but the Act does expressly authorize such advances to be made indirectly by creating a structure through which an FHL Bank can, in effect, make advances to a member of another FHL Bank. Further, an FHL Bank may make unsecured extensions of credit to a member of another FHL Bank. For example, an FHL Bank merely has to work through the other FHL Bank to make the initial advance that is sold to that FHL Bank; then the resulting advance to the debtor is governed under the same provisions of the Act as the advances made by the FHL Bank directly to its own members.

The Act also allows a member to, in effect, maintain multi-district memberships to the extent the member is affiliated with other members. The Board allows affiliated entities to be members in different districts and to obtain advances and vote accordingly in those districts. We understand that over 100 depository institution holding companies have subsidiaries that are members of different FHL Banks.[8]

[8] *See* 66 Fed. Reg. 50,366, 50,370 (Oct. 3, 2001).

Thus, the existing statutory authorities permit FHL Banks to develop arrangements to enable FHL Banks to, in economic effect, provide services to members of other FHL Banks. These services would include advances as recognized by the Board in 12 C.F.R. § 950.25.

Nevertheless, the express statutory authority to provide some services directly to members of other FHL Banks--and the process for providing secured advances contemplated by 12 C.F.R. § 950.25, which requires the cooperation of the respective FHL Banks--are not a full substitute for mult-district membership because these services do not include the voting rights associated with FHL Bank stock ownership. In addition, while it may be possible for a transaction between a non-member of an FHL Bank and the FHL Bank to synthesize some of the capital effects of stock ownership by, for example, requiring the non-member to place a subordinated deposit in an FHL Bank, it may not be possible to synthesize the full effects of Class B stock, which is the only stock eligible to satisfy the minimum leverage ratio required by the Act. 12 U.S.C. § 1426(a)(2)(B).

3. The Board's Authority to Allow an FHL Bank to Grant Membership to a Member of a Different FHL Bank

The Board's authority to allow an FHL Bank to grant membership to a member of another FHL Bank, including stock ownership and voting rights, requires a more detailed statutory analysis. Opponents of such multi-district membership contend that 12 U.S.C. § 1424(b) unambiguously prohibits multi-district membership. A new regulation by the Board allowing multi-district membership will be given deference only if the Board demonstrates to the contrary--*i.e.*, that this provision does not, or does not unambiguously, prohibit multi-district membership because it is susceptible to more than one accepted meaning. *See MCI Telecomms. v. AT&T*, 512 U.S. 218 (1994). A court would determine whether that is the case by employing the "traditional tools of statutory construction." *Chevron*, 467 U.S. at 843 n.9.

We believe that both the text of Section 1424(b) itself, and the structure of that provision considered in the context of the statute as a whole support a reasonable argument that Section 1424(b) does not unambiguously eliminate such authority; instead, they render Section 1424(b) susceptible to more than one meaning so that the Act does not directly or unambiguously resolve the "precise question." Accordingly, *Chevron* should apply to any permissible construction by the Board. Because the text of Section 1424(b) provides some support for the contrary view, however, it is difficult to predict whether such an argument will ultimately prevail in court.

Analysis of whether the statute unambiguously prohibits the Board from authorizing FHL Banks to allow multi-district membership requires consideration of the overall text and structure of the statute, including Congress' express grant of broad authority to the Board to ensure the "financial safety and soundness" of the FHL Banks, and the importance of that duty to the national economy. Also significant is Congress' express intent that the Board "supervise" the FHL Banks and ensure that they carry out their "housing finance mission" and "remain adequately capitalized and able to raise funds in the capital markets." 12 U.S.C. § 1422a(a)(3)(B). It is against that backdrop that the meaning of Section 1424(b) should be

examined to determine whether Congress intended for that section to expressly exempt the multi-district membership issue from the Board's broad authority, even where the Board finds that such a regulation is necessary or appropriate to implement its duties under the Act.

a. Text and structure of Section 1424. Examination of the text of Section 1424(b) does not expressly address the question of the Board's authority to allow an FHL Bank to grant membership to a member of another FHL Bank. As its title indicates, Section 1424(b) deals with the "[l]ocation requirement" imposed on institutions becoming members of the Federal Home Loan Bank System. Section 1424(b) provides as follows:

> An institution eligible to become a member under this section may become a member only of, or secure advances from, the Federal Home Loan Bank of the district in which is located the institution's principal place of business, or of the bank of a district adjoining such district, if demanded by convenience and then only with the approval of the Board.

12 U.S.C. § 1424(b).

Opponents of multi-district membership rely on the use of the term "only" in Section 1424(b) to contend that Congress unambiguously provided that an FHL Bank can never grant membership to a member of another FHL Bank. But the use of the term "only" in Section 1424(b) can also be reasonably read as merely addressing the question of which district an eligible institution must join when it becomes a member--*i.e.*, the institution "may become a member only" of the district in which its principal place of business is located and not of another district where it does not have such business, even if the institution would prefer another district for economic or other reasons. That reading is consistent with the structure of the Federal Home Loan Bank System, which includes twelve FHL Banks with districts that cover the continental United States, Puerto Rico, the Virgin Islands, Guam, Alaska, and Hawaii. In this regard, the Act requires that these districts be apportioned with due regard to the convenience and customary course of business of the institutions eligible to become members. 12 U.S.C. § 1423. The Act also provides that a director of an FHL Bank must be "a bona fide resident of the district in which such bank is located or an officer or director of a member of [the FHL Bank] located in that district," 12 U.S.C. § 1427, and that each FHL Bank's affordable housing council consist of "persons drawn from community and nonprofit organizations actively involved in providing or promoting low- and moderate-income housing in [the FHL Bank's] district." 12 U.S.C. § 1430(j)(11).

By requiring membership on a geographic basis, Congress helped to ensure that each FHL Bank receives adequate capital to promote its housing finance mission and that capital does not gravitate to one economic center where members might prefer to gather.[9] This reading also

[9] *See* Hearings Before a Subcommittee of the Committee on Banking and Currency on S. 2959, U.S. Senate, 72nd Cong., lst Sess. (1932), at 116-17, 359-60.

ensures that decisions about housing finance are made by the FHL Bank with the knowledge of the local market where the member's financing efforts are located.

The one exception recognized by the statute to allow membership in the district adjoining the district where a member's principal place of business is located is consistent with those purposes. Moreover, that exception may be interpreted as ambiguous regarding whether the use of the second "or" in Section 1424(b) was intended as the disjunctive or conjunctive. If "or" was meant in the disjunctive, an institution is entitled to become a member of an adjoining district only as *an alternative to* the principal-place-of-business district; but if the term was meant as the conjunctive, an institution is expressly entitled to become a member of an adjoining district *in addition to* that original district. In either case, the exception confirms that the provision is aimed at the location requirement imposed on an eligible institution and the rights of that institution.

Thus, the "[l]ocation requirement" of Section 1424(b) tells the institution that its eligibility for membership entitles it to a membership only in the district to which it is connected by virtue of its principal place of business, and does not give the member the right to choose a different district. Section 1424(b) is not, however, addressed to the Board as a limitation on its authority to supervise FHL Banks.[10] Section 1424(b) does not expressly provide that the Board may not allow an FHL Bank to grant membership to an institution that already meets the "[l]ocation requirement" under Section 1424(b). In other words, Section 1424(b) is reasonably construed to establish a floor for membership, mandating that an institution be a member in its principal-place-of-business district, and/or the adjoining district, but does not limit the Board's authority to authorize FHL Banks to allow an institution to take on an additional membership. In light of the broad authority granted to the Board to supervise FHL Banks and the importance of its duties regarding the financial safety and soundness of FHL Banks, one would have expected Congress to be much clearer if it intended to curtail that authority.[11]

The structure of the neighboring subsections of Section 1424 confirms the reasonableness of this reading. The title of Section 1424(b) is "Eligibility for membership." In subsection (a), entitled "[c]riteria for eligibility," the statute sets forth the general criteria for eligibility to become a member of an FHL Bank, including that an institution be duly organized under state or

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[10] Section 1424(b)'s use of the term "[a]n institution eligible to become a member" also may be significant. Other provisions of the Act refer, or have referred, to both institutions eligible to become members and to members, suggesting that arguably Section 1424(b) may have no application at all to existing members. *See* 12 U.S.C. § 1431(e)(2) (2002) and 12 U.S.C. § 1426(f) (1998) (since repealed).

[11] It also can be argued that Section 1424(b) has no application to membership by federal savings associations because their membership in FHL Banks is governed by Section 5(f) of the Home Owners' Loan Act, 12 U.S.C. § 1464(f), which provides that a federal savings association can become a member of the "Federal Home Loan Bank System." However, that provision also states that federal savings associations "shall qualify for such membership in the manner provided" by the Act, thereby arguably incorporating Section 1424(b).

federal law, that it be subject to inspection and regulation under state or federal banking or similar laws, and that it make long-term home mortgage loans. 12 U.S.C. § 1424(a)(1). Subsection (a) also sets forth the eligibility criteria for qualified thrift lenders and insured depository institutions. Subsection (c), entitled "[i]nspection and regulation," provides that an institution that does not meet the requirement under subsection (a)(2)--that it be subject to inspection and regulation under state or federal banking or similar laws--may nonetheless be eligible to "become" a member if the institution is otherwise eligible and subjects itself to such inspection and regulation directed by the Board. Both subsections (a) and (c) thus focus on the requirements that must be met by an institution to be eligible for membership. Neither suggests that it limits in any way the Board's authority to impose additional requirements on members. Subsection (b) should be interpreted similarly to its neighboring subsections and not as an implied limit on the Board's authority.

In light of the above, we believe there is a reasonable argument that Section 1424(b) is silent on the question of the Board's authority to allow an FHL Bank to grant membership to a member of another FHL Bank. Indeed, at the time the statute was originally enacted, there may have been little reason for Congress to consider whether a member could maintain membership in more than one district because most prospective members of the FHL Banks operated in limited geographic areas. What Congress was concerned about was ensuring that a member join the district where it did business, rather than another district that might be more economically attractive.[12] Congress was not contemplating the financial institutions of today that have substantial business in more than one district, and whether financial institutions would like to, or should be made to, be a member in more than one district. Thus, Congress may not have had any intent one way or the other regarding the precise question presented here, and because Congress expected the Board to speak with the force of law to address ambiguities in the law, the Board's interpretation should be accorded deference. *See Mead*, 533 U.S. at 229 (citing *Chevron*, 467 U.S. at 845). This interpretation would mean that the Board could allow multi-district memberships and, indeed, require such memberships, when it found that such action was necessary or appropriate to carry out its duties under the Act. Multiple-district memberships that include the district(s) contemplated by Section 1424(b) would be consistent with the location requirement under Section 1424(b) because the FHL Bank of the district in which the member is located would retain the capital contribution of the member.

b. Overall structure of the statute. This interpretation of Section 1424(b) is further supported by consideration of the overall structure of the Act. Although it is possible to argue that some provisions of the Act are consistent with single-district membership,[13] other provisions

[12] *See supra* note 9.

[13] *See* 12 U.S.C. § 1422(4) (defining a member as an institution that has subscribed to stock of "a Federal Home Loan Bank"); 12 U.S.C. § 1423 (providing that districts shall be apportioned with due regard to the convenience and customary course of business of the institutions eligible to and likely to subscribe for the stock of "a Federal Home Loan Bank"). Nevertheless, these references also are consistent with the view that Section 1424(b) establishes a floor for memberships, but does not limit the Board's authority.

of the Act undermine the interpretation of Section 1424(b) as a prohibition on multi-district membership. In particular, Section 1426 indicates that Congress did not intend that Section 1424(b) prohibit membership in more than one district in all cases. Indeed, this interpretation suggests that reading Section 1424(b) to prohibit membership in more than one district would be inconsistent with congressional intent.

In subsection (a) of Section 1426, Congress directed the Board to issue regulations that prescribe uniform capital standards and other requirements, including regulations that authorize FHL Banks to issue two classes of stock; provide that stock of an FHL Bank "may be issued to and held by only members of the bank;" prescribe the manner in which stock may be sold, transferred, redeemed, or repurchased; and provide the manner of disposition of outstanding stock held by an institution that ceases to be a member "through merger or otherwise" or provides notice of intention to withdraw from membership. 12 U.S.C. §§ 1426(a)(4)(A), (B), (C), (D). Significantly, the provision referencing merger does not declare that membership in an FHL Bank *must* cease upon merger with another member, nor does the provision refer to Section 1424(b). *See* 12 U.S.C. § 1426(a)(4)(D).[14]

Moreover, in subsection (d) of Section 1426, Congress provided that simultaneous membership in more than one district may occur in certain circumstances. Subsection (d) addresses "[v]oluntary" withdrawal, which includes withdrawal because of merger (*see* 12 U.S.C. § 1426(d)(2) defining "[i]nvoluntary withdrawal"). It specifies that, in the case of voluntary withdrawal, the applicable stock redemption periods (which is five years in the case of Class B stock) begin when notice of withdrawal is provided to the FHL Bank. It is upon expiration of that period that the member "may" surrender such stock and be entitled to receive the par value of the stock. 12 U.S.C. § 1426(d)(1). Consequently, in the event of a merger or acquisition involving members of different FHL Banks and a voluntary withdrawal from one district, the Act contemplates that the institution resulting from the merger may retain the respective FHL Bank stock of its predecessors for that five-year period. And, because of Section 1426(a)'s prohibition on stock ownership by nonmembers, the institution would remain a member of more than one FHL Bank during that redemption notice period.[15]

This interpretation is confirmed by Congress' express statement at the end of subsection (d)(1) that a member who voluntarily withdraws from an FHL Bank "shall be entitled to dividends and other membership rights commensurate with continuing stock ownership" during

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[14] Section 1426(g) provides that an institution that divests all shares of stock in an FHL Bank may not after such divestiture acquire shares in any FHL Bank for 5 years after the divestiture, unless the divestiture is a consequence of a transfer of membership on an uninterrupted basis between banks. 12 U.S.C. § 1426(g). Although this provision may limit a member's ability to terminate an FHL Bank membership and then initiate a new membership, the provision does not address additional memberships or the acquisition of stock in additional FHL Banks in the absence of such a divestiture.

[15] It may be possible that a member would sell any such stock to another member during the redemption period, but that procedure is not required by the Act.

the stock redemption notice periods. 12 U.S.C. §1426(d)(1).[16] Thus, the Act allows a member that is formed by the merger of two former members of different FHL Banks to be a member of both FHL Banks for at least a period of five years. Although it could be argued that this provision is necessary to create an exception to Section 1424(b), Congress did not indicate in any way that Section 1426(d) is an exception to a broader restriction on multi-district membership, nor did it include any cross-reference to what opponents claim to be such a restriction in Section 1424(b).[17]

Taken together, we believe that these arguments, based on the text of Section 1424(b) and the overall structure of the Act, support an interpretation that Section 1424(b) is ambiguous on the precise question about the Board's authority to allow multi-district membership if necessary or appropriate to carry out its duties under the Act. More specifically, there is insufficient indication of an intent by Congress to curtail the otherwise broad authority it granted the Board, including to ensure that FHL Banks "operate in a financially safe and sound manner." 12 U.S.C. § 1422a(a)(3)(A).

4. Previous Interpretations by the Board

Any Board interpretation of the Act to authorize it to allow FHL Banks to grant membership to a member of another district should take into account the Board's past interpretations of the Act on this and related issues. Although prior action by the Board appears to have assumed that a member would only be a member of a single FHL Bank, and that the Board's solicitation of comments on multiple FHL Bank memberships stated that multi-district membership "is currently not permitted,"[18] we have not found any interpretations by the Board indicating that multi-district membership was precluded by the Act, as opposed to such multi-district membership being restricted by the Board's own past rules, policies or practices, which are susceptible to change by the Board.

Even if the Board has interpreted the Act differently in the past, that would not bar the Board from changing its view of the Act now. A reasonable change in an agency interpretation

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[16] Congress also specified that, in the case of involuntary withdrawal, the institution shall receive dividends but not be entitled to any other rights or privileges of membership after the termination date. 12 U.S.C. § 1426(d)(2).

[17] Under 12 U.S.C. § 1426(a)(4)(D), the Board may have some discretion to modify this procedure. However, that discretion would in no way detract from the fact that the Act clearly contemplates the possibility of simultaneous membership in multiple districts.

[18] 66 Fed. Reg. 50,366, 50,369 (Oct. 3, 2001).

does not foreclose *Chevron* deference.[19] The administrative interpretation accorded deference by the Court in *Chevron* itself was a change in agency interpretation that was adopted after a change in administrations. Indeed, by definition, a statute that is susceptible to more than one interpretation may be reasonably interpreted by an agency in more than one manner. If there are prior, inconsistent interpretations by the Board, however, the Board should note the prior interpretations and explain the change in its interpretation so that the Board is in the best position to have a court defer to its new interpretation. To the extent a prior inconsistent interpretation is not explained or distinguished, it could be seized upon by opponents to undermine the reasonableness of the new and different interpretation. A change in an agency's interpretation of its statute that is sudden and unexplained or that does not take account of legitimate reliance on prior interpretation may be arbitrary, capricious or an abuse of discretion that is not valid under the Administrative Procedure Act. *See Smiley v. Citibank (South Dakota), N.A.*, 517 U.S. 735, 742 (1986) (citations omitted).

We have reviewed two regulations that opponents have suggested reflect a long held view of the Board that Section 1424(b) prohibits multi-district membership. The first regulation implements the statutory "[l]ocation requirement" of Section 1424(b). That regulation, 12 C.F.R. § 925.18, like the statutory provision, merely addresses the eligibility of institutions to become members. It does not expressly limit the Board's otherwise broad authority. Moreover, the structure of the regulation is slightly different from the statute and appears consistent with the interpretation of "or" in the conjunctive sense discussed above, because the provision allowing membership in an adjoining district, 12 C.F.R. § 925.18(a)(2), is described as an exception to the "only" limitation of the initial location requirement contained in 12 C.F.R. § 925.18(a)(1). To the extent the Board's regulation allows membership in both the principal-place-of-business district and the adjoining district, the regulation indicates that the Board has not previously viewed multi-district membership as explicitly prohibited by the statute.

Various other aspects of that regulation also reinforce the view that the Board has not taken a narrow view of its authority to regulate membership in FHL Banks. For example, the regulation requires that a member promptly notify its FHL Bank when it relocates its principal place of business to another state. 12 C.F.R. § 925.18(a). The regulation also establishes that, unless otherwise requested, an institution's principal place of business is the state in which it "maintains its home office." 12 C.F.R. § 925.18(b). The regulation specifies that a member is entitled to have an FHL Bank designate a different district as its principal place of business if "[a]t least 80 percent of the institution's accounting books, records and ledgers are maintained, located, or held" in the designated state; a majority of board of directors and committee meetings are conducted in the designated state; and a majority of the "five highest paid officers have their place of employment" located in the designated state. 12 C.F.R. §§ 925.18(c)(i), (ii), (iii). Thus,

[19] *Chevron*, 467 U.S. at 863 ("The fact that the agency has from time to time changed its interpretation of the term 'source' does not, as respondents argue, lead us to conclude that no deference should be accorded the agency's interpretation of the statute. An initial agency interpretation is not instantly carved in stone").

the regulation serves as precedent for interpreting Section 1424(b) as merely a location requirement, rather than a limitation on such interpretations.

The second regulation cited as an indication that the Board considers multi-district membership to be inconsistent with the statute is the regulation regarding "[c]onsolidations involving members." 12 C.F.R. § 925.24. Subsection (a) of that regulation addresses consolidations of two or more members, including when the consolidating members are members of the same district, as well as when the consolidating members are members of different districts. The regulation provides that, in *both* circumstances, the "membership of the surviving institution shall continue and the membership of each disappearing institution shall terminate upon cancellation of its charter." 12 C.F.R. § 925.24(a). Contrary to the arguments pressed by the multi-district opponents, however, it does not appear that the regulation was promulgated because of a prohibition against multi-district membership in the Act, but rather because of a choice by the Board at the time not to allow any institution that results from a consolidation of more than one member to retain more than one membership, whether in the same or different districts.[20] Furthermore, this regulation provides that in consolidations of members from different districts, the source of assets, rather than the location of management, determines membership. The regulation provides that the membership of the surviving institution--rather than the disappearing institution--shall terminate, and the membership of the disappearing member shall continue, if "more than 80 percent of the assets of the consolidated institution are derived from the assets of [the] disappearing institution." 12 C.F.R. § 925.24(a).

In any event, there is no indication by the Board that the termination of membership provided for in 12 C.F.R. § 925.24(a) was compelled by the statute, as opposed to the Board exercising its broad authority to regulate FHL Banks in such a way because it believed it necessary or appropriate to ensure the safety and soundness of the Banks or to meet another of its statutory duties. Nevertheless, if the Board promulgates a new regulation allowing multi-district memberships, it should either modify this regulation accordingly or explain why the new regulation does not apply in the case of mergers that would result in multi-district membership.[21] That explanation should include an analysis of the purposes that supported the promulgation of Section 925.24(a) and any statements made by the Board in the preambles to the initial notice of rulemaking, notice of final rule, or any interim notices.

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[20] It is not clear how Section 925.24(a) relates to the continuation of membership during stock redemption notice periods provided for in 12 U.S.C. § 1426(d) discussed above. The predecessor regulation appeared to take the view that an institution could hold FHL Bank stock without being a member of that FHL Bank. However, subsequent to the adoption of that provision, the Act was changed to require that the regulations issued by the Board "provide that the stock of a Federal home loan bank may be issued to and held by only members of the bank." 12 U.S.C. § 1426(a)(4)(B).

[21] The Board is also authorized to waive any requirement of a regulation that is not otherwise required by law, 12 C.F.R. § 907.2(a), but that authority applies "in connection with a particular transaction or activity," *id.*, and it is unclear whether that would be an efficient means for the Board to implement a policy allowing multi-district memberships that result from mergers, contrary to 12 C.F.R. § 925.24(a).

5. Related Issues

Finally, we note that multi-district membership would raise a number of issues about the operations of FHL Banks that would need to be resolved, including issues relating to capital stock, collateral for advances, and voting rights, among others. Resolution of these issues consistent with the Act's mandate to the Board relating to the safety and soundness of FHL Banks and the carrying out of their housing finance mission, 12 U.S.C. § 1422a(a)(3), will be an important element in supporting the reasonableness of any interpretation by the Board of the Act to permit multi-district membership.

CONCLUSION

In light of the structure of the Act, including the broad authority granted to the Board to ensure that FHL Banks operate in a financially safe and sound manner, and its express authority to promulgate regulations to carry out the provisions of the statute, we believe that there is a reasonable argument that the Board is authorized to promulgate a regulation allowing multi-district membership, and that Section 1424(b) does not unambiguously address the issue to preclude such a regulation.