

Overview of the FHLBank System

Introduction

The FHLBanks are cooperatively structured, privately capitalized government-sponsored enterprises (GSEs). As GSEs, the FHLBanks are federal instrumentalities, chartered under the Federal Home Loan Bank Act (FHLBank Act) specifically to carry out federal policy for enhancing the availability of credit for residential mortgages and community development finance. The FHLBanks provide a readily available, economical and affordable source of funds in the form of advances to their member institutions.

The FHLBanks receive the majority of their funding through the issuance of consolidated FHLBank System debt obligations. Consolidated debt obligations are the joint and several obligations of all of the FHLBanks. FHLBank debt does not carry the full faith and credit of the U.S. government. However, owing to the joint and several nature of the debt, generally low risk balance sheets, and ties to the federal government, the FHLBanks can raise funds at narrow spreads over comparable maturity Treasury securities.

Cooperative Organization and Capitalization. Pursuant to Sections 2B and 3 of the FHLBank Act, the FHLBank System consists of 12 FHLBanks and the Office of Finance, a joint office of the FHLBank System and its fiscal agent. Each FHLBank serves a specific geographical area (see Exhibit 1). As cooperatives, FHLBank customers and stockholders (FHLBank members), are generally the same, although under Section 975.3 of the Finance Board regulations, certain correspondent services may be provided on an equal basis to institutions eligible to become FHLBank members.

Pursuant to Section 4(a) of the FHLBank Act, membership in an FHLBank is limited to savings associations, cooperative banks, homestead associations, commercial banks, savings banks, credit unions, and insurance companies. An eligible institution must apply for membership to the FHLBank that serves the geographical area where the institution has its principal place of business. All members must purchase and hold stock in their respective FHLBanks.

The FHLBanks are privately capitalized by the stock purchases of their members. FHLBank stock is not publicly-traded. The FHLBank Act authorizes an FHLBank to issue one or both of two classes of FHLBank stock and requires each FHLBank to have a capital plan approved by the Finance Board. Each FHLBank's capital plan must address, among other things, classes and subclasses of capital stock that the FHLBank intends to issue, the process for capital stock issuance, the par value of each class and subclass of stock and the required member investment in the FHLBank's stock. All of the FHLBanks have set the par value for all classes and subclasses of capital stock at \$100. All FHLBank stock is bought and sold at par. Section 6 of the FHLBank Act establishes minimum leverage and risk-based capital requirements for the FHLBanks.

Funding. Section 11 of the FHLBank Act authorizes the Finance Board to issue FHLBank System consolidated bonds, also known as consolidated obligations, which are the joint and several obligations of all the FHLBanks. Until 2001, the Finance Board, through the Office of Finance as its agent, was the issuer of consolidated obligations for

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which the FHLBanks are jointly and severally liable. Effective January 2, 2001, pursuant to Section 966.2 of the Finance Board regulations, the FHLBanks, through the Office of Finance as their agent, became the issuers of consolidated obligations for which the FHLBanks are jointly and severally liable. Consolidated obligations are sold at prevailing market rates and are the principal source of FHLBank funding. The FHLBanks use the proceeds to make advances to their members and for other authorized purposes, including the funding of eligible investments.

Federal Housing Finance Board

The Finance Board is an independent regulatory agency in the executive branch of the U.S. government. Pursuant to Section 2A(a) of the FHLBank Act, the Finance Board's duties are to ensure that the FHLBanks operate in a safe and sound manner, that the FHLBanks carry out their housing finance and community investment mission, and that the FHLBanks remain adequately capitalized and able to raise funds in the capital markets.

Under Section 2A(b) of the FHLBank Act, the management of the Finance Board is vested in a five-member board of directors. Four directors are appointed by the President of the United States with the advice and consent of the Senate, and hold office with terms of seven years. One of the four appointed directors is designated by the President to serve as chairman of the Finance Board. The fifth member, an *ex officio* member, is the U.S. Secretary of Housing and Urban Development. At least one director is required to be chosen from an organization with more than a two-year history of representing consumer or community interests on banking services, credit cards, housing or financial consumer protections.

Pursuant to Section 2B of the FHLBank Act, the general powers of the Finance Board include, among others, the power to supervise and examine the FHLBanks and to promulgate and enforce such regulations and orders as are necessary to carry out the provisions of the FHLBank Act, and to suspend or remove for cause a director, officer, employee or agent of any FHLBank or joint office. Section 20 of the FHLBank Act directs the Finance Board to require annual examinations and reports of condition of the FHLBanks and periodically furnish statements based upon such reports.

Supervision of the FHLBanks. The Board of Directors of the Finance Board has charged the Finance Board's Office of Supervision with responsibility for the examination and supervision of the FHLBanks. Responsibilities include annual examinations of the FHLBanks, the Office of Finance and the Financing Corporation. The Financing Corporation was created by the Federal Savings and Loan Insurance Corporation Recapitalization Act of 1987, as amended, for the sole purpose of providing financing for the FSLIC Resolution Fund. Pursuant to Section 21(b)(8) of the FHLBank Act, the Financing Corporation is regulated by the Finance Board.

Through examinations, periodic on-site visitations, and off-site monitoring, the Office of Supervision evaluates FHLBank operations, financial performance and trends,

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compliance with laws, regulations, and Finance Board policy, and actions taken to correct weaknesses and violations found in examinations between examinations. The Office of Supervision also monitors the achievement by the FHLBanks of their housing finance and community development mission.

Statutory Examination Requirements. Under Section 20 of the FHLBank Act, the Finance Board must require annual examinations and reports of condition of all FHLBanks. Section 985.4(b) of the Finance Board regulations directs that the Office of Finance be examined annually. Additional examinations, including special examinations, can be conducted as necessary. FHLBank examinations include an assessment of the quality of an institution's corporate governance, market, credit and operational risk management, condition and performance, and affordable housing and community investment activities. Examiners evaluate management's effectiveness and the institution's compliance with the FHLBank Act, regulations and Finance Board policy.

The examination of the Office of Finance focuses on the quality of corporate governance and operational risk management in the context of the Office of Finance's debt issuance and disclosure activities. The examination of the Financing Corporation focuses on the quality of debt service administration by the Financing Corporation for REFCORP obligations.

Powers of Examiners. Under Section 20 of the FHLBank Act, examiners appointed by the Finance Board are subject to the same requirements, responsibilities and penalties as are applicable to examiners under the National Bank Act and the Federal Reserve Act and have the same powers and privileges as are vested in those examiners by law. The responsibilities, powers and privileges of Finance Board examiners are co-extensive with those vested in examiners under the National Bank Act pursuant to Section 5240 of the Revised Statutes, February 19, 1875, as amended. Section 5240 provides that examiners "...shall have power to make a thorough examination of all the affairs of [a] bank and in doing so...shall have the power to administer oaths and to examine any of the officers and agents thereof under oath." as well as to exercise similar powers with respect to bank affiliates."

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Exhibit 1

The geographical areas that comprise the FHLBank districts are delineated below.

- 1. Boston**
Connecticut
Maine
Massachusetts
New Hampshire
Vermont
Rhode Island
- 2. New York**
New Jersey
New York
Puerto Rico
Virgin Islands
- 3. Pittsburgh**
Delaware
Pennsylvania
West Virginia
- 4. Atlanta**
Alabama
District of Columbia
Florida
Georgia
Maryland
North Carolina
South Carolina
Virginia
- 5. Cincinnati**
Kentucky
Ohio
Tennessee
- 6. Indianapolis**
Indiana
Michigan
- 7. Chicago**
Illinois
Wisconsin
- 8. Des Moines**
Iowa
Minnesota
Missouri
North Dakota
South Dakota
- 9. Dallas**
Arkansas
Louisiana
Mississippi
New Mexico
Texas
- 10. Topeka**
Colorado
Kansas
Nebraska
Oklahoma
- 11. San Francisco**
Arizona
California
Nevada
- 12. Seattle**
Alaska
Guam
Hawaii
Idaho
Montana
Oregon
Pacific Islands
Utah
Washington
Wyoming