



## Federal Home Loan Bank of Pittsburgh

**James D. Roy**  
*President and  
Chief Executive Officer*

February 7, 2003

Ms. Elaine L. Baker  
Secretary to the Board  
Federal Housing Finance Board  
1777 F Street, N.W.  
Washington, D.C. 20006

**RE: Solicitation of Comments regarding Multi-bank Membership**

Dear Ms. Baker:

Thank you for the opportunity to provide our viewpoints in response to the solicitation of comments contained in Federal Housing Finance Board Resolution 2002-63.

The Federal Home Loan Bank of Pittsburgh ("Pittsburgh FHLBank") supports multi-bank membership, but only in the context of acquisitions, mergers or similar types of consolidations among institutions located in different FHLBank districts. The Pittsburgh FHLBank does not support authorizing institutions to gain membership in FHLBanks (whether located in contiguous districts or otherwise) simply to expand the number of FHLBank memberships they maintain.

### **I. MEMBERSHIP SHOULD BE TREATED AS AN ASSET**

Membership in a FHLBank should be treated more like an asset than a non-transferable privilege. To this end, institutions that are merged or are otherwise consolidated into another institution, that is a member of a different FHLBank, should be allowed to retain membership in order to access the intrinsic value of that membership.<sup>1</sup>

The current membership rules should be revised in order to allow a member institution to transfer (maybe for consideration) the intrinsic value of a membership in a certain FHLBank when it is acquired or otherwise consolidated into another institution. Each FHLBank now operates under its own business plan, with its own product mix, collateral policies, risk limits, levels of retained earnings,<sup>2</sup> capital plan, and other elements unique to its FHLBank. The value of a membership in a certain FHLBank today is not necessarily the same as the value of a membership in a different FHLBank.

<sup>1</sup> Memberships may someday become fully transferable, subject to some general creditworthiness and eligibility requirements.

<sup>2</sup> The members of a FHLBanks own the retained earnings of that FHLBank. In recent months, the Federal Housing Finance Board started to encourage the FHLBanks to increase the level of retained earnings in order to support mortgage purchase programs and other asset-generating activities that are not capitalized by activity-based stock purchase requirements. Although a member technically owns the retained earnings, it cannot access or "cash in" its shares that are generated during its term as a member unless the FHLBank is liquidated.

Elaine L. Baker  
February 7, 2003  
Page 2 of 4

## II. SAFETY AND SOUNDNESS ARGUMENTS IN SUPPORT OF AUTHORIZING MULTI-BANK MEMBERSHIP IN THE CONTEXT OF CONSOLIDATIONS

The FHLBanks face many types of risks. They include, but are not limited to, credit risk, financial risk, operational risk, business risk, and political risk. Permitting an institution that acquires a member in another district to maintain the membership of the acquired institution will reduce the amount of risk that would otherwise be created by the increasing amount of consolidation that is taking place in the financial services industry. The following examples demonstrate how risk will be reduced by authorizing multi-bank membership in the case of combinations.

- a. Financial risk will be reduced by not exposing any one FHLBank to a large concentration of its capital being held by a few large members. Large institutions that continue to get larger through the acquisition of out-of-district institutions will have to hold a larger amount of capital in their FHLBank in order to meet their capital stock purchase requirement. A subsequent acquisition or other loss of any one of these large members would expose the FHLBank of the acquirer to a significant change in the level of earning assets.<sup>3</sup>
- b. Financial risk will be reduced by ensuring that each FHLBank will have the economies of scale necessary to maintain an effective relationship with the capital markets. A FHLBank must have a sufficient volume of business in order to be able to enter into the minimum size transaction that is necessary to have access to the most cost-effective hedging tools.
- c. Political risk will be reduced by ensuring that low-income communities are not cut off from accessing AHP funding. Communities that were previously served by institutions that are acquired by an out-of-district institution would continue to have access to AHP funds from the FHLBank whose district encompasses those communities. Experience suggests that markets that were previously served by institutions that are acquired by an out-of-state institution are not receiving the same access to AHP funds. This may be the result of FHLBank established limits on using AHP funds out-of-district or just a natural bias on behalf of members to look for projects closer to their home office. In any case, certain communities are being disadvantaged as a result of merger activities among members.
- d. Compliance risk will be reduced by providing for the local administration of AHP projects. The local FHLBank is more familiar with the communities where the projects are located. Monitoring compliance will be more efficient if administered locally. AHP priorities are designed to meet the needs of communities in each FHLBank district. Accessing the AHP program of the FHLBank where the project is located will allow it to

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<sup>3</sup> The five-year redemption period on Class B stock mitigates this risk to some extent.

Elaine L. Baker  
February 7, 2003  
Page 3 of 4

better qualify for funding because the project will have the characteristics required to meet the scoring priorities established by the FHLBank approving the application. In addition, all of the communities served by the member would have access to AHP programs that are designed to meet the needs of the communities served by the member.

- e. Credit risk will be reduced as a result of reducing the amount of advances any one FHLBank would have outstanding at any one time to any one borrower. In addition, the credit exposure to the capital market counterparty used to financially engineer the advances or the debt used to fund those assets would be spread more evenly among the FHLBanks.
- f. Business risk would be reduced by removing an unnecessary obstacle for the member institutions to do business with a FHLBank. Members must guard against making outsized investments in a single entity (FHLBank).
- g. Business risk will be reduced by keeping the FHLBank System current with the members' authority to consolidate with institutions across state lines. Members were authorized to engage in full interstate banking in 1994. The FHLBank System has not updated its membership rules to conform with the new powers granted to its membership. The membership rules of the FHLBank System should be designed to accommodate the members' business in order for membership to continue to be attractive to all institutions.
- h. Political risk will be reduced by ensuring that each FHLBank has sufficient earnings to operate a meaningful AHP program. The loss of one or more large members from any district would have a significant adverse effect on the amount of AHP contributions available to meet the affordable housing needs on that district. Large members invest the lion's share of the capital used by the FHLBank to support either the borrowings of these large members or the purchase of other earning assets. Without the capital and business of large members, the contributions to that FHLBank's AHP program would be alarmingly reduced. This is a particularly nettlesome issue. The acquired institution continues to do business in its market area, but the AHP activity would be diverted into the acquiring institution's market area.
- i. Business risk will be reduced by ensuring that each FHLBank will have the economies of scale necessary to maintain an effective relationship with the capital markets. A FHLBank must have a sufficient volume of business in order to be able to enter into transactions cost effectively. Lower-priced funding results in lower-cost advances.
- j. Political risk is reduced by eliminating the re-allocation of the ownership rights in the retained earnings of the two FHLBanks associated with the acquiring and acquired institutions. The pro-rata share of retained earnings owned by the members of the FHLBank where the acquiring institution maintains its principal place of business is automatically

Elaine L. Baker  
February 7, 2003  
Page 4 of 4

reduced every time the acquiring institution increases its capital stock purchase as a result of an out-of-district acquisition. Likewise, the pro-rata share of retained earnings is increased for the other members of the FHLBank where the acquired institution used to maintain its membership.

- k. Risk in general will not be increased simply because members have access to products and services from more than one FHLBank. If multi-bank membership is limited to cases involving combinations, the decision to maintain a membership in another FHLBank will be incidental to the combination and not be motivated by an attempt to obtain better terms and conditions of doing business with the FHLBank System.<sup>4</sup>

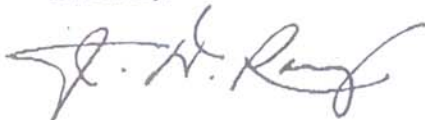
### III. LEGAL AND OPERATIONAL ISSUES

Multi-bank membership will raise various legal and operational issues. However, all of these issues can be adequately addressed through thoughtful regulation. Please refer to our letter dated January 30, 2002, a copy of which is enclosed.

Please contact Dana A. Yealy, Senior Vice President and General Counsel, at (412) 288-2833 if you have any questions or need additional information.

Thank you again for the opportunity to provide comments on this important issue.

Sincerely,



Enclosure

Cc: John Korsmo, Chairman  
Franz Leichter, Director  
Allen Mendelowitz, Director  
J. Timothy O'Neill, Director  
John Weicher, Director

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<sup>4</sup> It is highly unlikely that an institution would acquire another institution solely to play one FHLBank off against another.



**Federal Home Loan Bank  
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**COPY**

James D. Roy  
President and  
Chief Executive Officer

January 30, 2002

Ms. Elaine L. Baker  
Secretary  
Federal Housing Finance Board  
1777 F Street, N.W.  
Washington, D.C. 20006

RE: Solicitation of Comments regarding Multi-bank Membership

Dear Ms. Baker:

Thank you for the opportunity to provide comments in response to the Solicitation of Comments that was published in the Federal Register on October 2, 2001 (hereinafter referred to as the "SOC").

The Pittsburgh Bank supports the Federal Housing Finance Board using the SOC as a means to gather facts regarding the issue of a single chartered institution having membership in more than one Home Loan Bank (hereinafter referred to as "multi-bank membership"). In addition, the various petitions filed with the Finance Board and the responses filed thereto have already set forth many of the facts sought by the SOC. The responses to the SOC as well as the filings already on record with the Finance Board should provide a sufficient basis for the Finance Board to develop an initial position on the issue of multi-bank membership.

As opposed to supplying answers to the questions set forth in the SOC that will most likely be duplicative of those supplied by other commentators, the Pittsburgh Bank offers the following arguments in favor of multi-bank membership in the context of a merger between members of different Home Loan Banks. The issue of multi-bank membership in the context of mergers only was not directly addressed by the SOC, and therefore, we respectfully submit the following legal analysis, policy arguments and suggested operational controls in support of this position.

I. LEGAL ANALYSIS

Section 4b of the Federal Home Loan Bank Act ("Bank Act") sets forth the rules governing where an institution may obtain its initial membership in the Bank System.

(b) **Membership based on expediency.** 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. [Emphasis added].

Elaine L. Baker  
January 30, 2002  
Page 2 of 6

Section 6(d) of the Bank Act sets forth the rules regarding when a member voluntarily withdraws or is involuntarily removed from membership by a Bank.

#### VOLUNTARY WITHDRAWAL.

Any member may *withdraw* from a Federal Home Loan Bank if the member provides written notice to the Bank of its intent to do so and if, on the date of withdrawal, there is in effect a certification by the Finance Board that the withdrawal will not cause the Federal Home Loan Bank System to fail to meet its obligation under Section 21B(f)(2)(C) to contribute to the debt service for the obligations issued by the Resolution Funding Corporation. The applicable stock redemption notice periods shall commence upon receipt of the notice by the Bank. Upon the expiration of the applicable notice period for each class of redeemable stock, the member may surrender such stock to the Bank, and shall be entitled to receive in cash the par value of the stock. During the applicable notice periods, the member shall be entitled to dividends and other membership rights commensurate with continuing stock ownership. [Emphasis added]

#### INVOLUNTARY WITHDRAWAL.

- (A) In general, the Board of Directors of a Federal Home Loan Bank may *terminate* the membership of any institution if, subject to Finance Board regulations, it determines that-
- (i) the member has failed to comply with a provision of this Act or any regulation prescribed under this Act; or
  - (ii) the member has been determined to be insolvent, or otherwise subject to the appointment of a conservator, receiver, or other legal custodian, by a Federal or State authority with regulatory and supervisory responsibility for the member.
- (B) Stock disposition. An institution, the membership of which is terminated in accordance with Subparagraph (A)-
- (i) shall surrender redeemable stock to the Federal Home Loan Bank, and shall receive in cash the par value of the stock, upon the expiration of the applicable notice period under Subsection (a)(4)(A);
  - (ii) shall receive any dividends declared on its redeemable stock, during the applicable notice period under Subsection (a)(4)(A); and
  - (iii) shall not be entitled to any other rights or privileges accorded to members after the date of the termination.
- (C) Commencement of notice period. With respect to an institution, the membership of which is terminated in accordance with Subparagraph (A), the applicable notice period under Subsection (a)(4) for each class of redeemable stock shall commence on the earlier of-
- (i) the date of such termination; or
  - (ii) the date on which the member has provided notice of its intent to redeem such stock.] [Emphasis added]

Although the Bank Act has rules for obtaining an initial membership, and rules for withdrawing and termination of membership, it does not specifically set forth rules to govern what happens to a membership when an institution is acquired, merged or otherwise combined with another institution (hereinafter referred to as "combines" or "combinations"). It is also important to note that the Rules and Regulations of the Finance Board treat consolidations of members differently than: 1) an application for an initial

Elaine L. Baker  
January 30, 2002  
Page 3 of 6

membership and 2) a termination of membership (whether voluntary or involuntary). Unlike the Bank Act, which is silent on the topic, the consolidation of members is addressed in its own section of the membership regulation. The Finance Board has long treated consolidations differently than voluntary and involuntary terminations of memberships. No provision of the Bank Act addresses the issue of consolidations. The Finance Board currently requires that when two members combine, one of the two previous memberships will be eliminated.<sup>1</sup> There is no statutory basis to prevent the Finance Board from changing this regulation to permit merged institutions after a combination to maintain the membership of the institution that gives up its charter.<sup>2</sup>

There are several references in the legislative history of the Bank Act that suggests that no member should be able to access membership in more than one Home Loan Bank. However, the fact pattern discussed during the legislative debate in 1932 focused solely on whether an insurance company that was a national lender should be required to borrow from the Home Loan Bank in the district where it was making mortgage loans. Congress never debated whether a member that acquires another member of another district could maintain the membership of the acquired institution. Therefore, the Finance Board is not bound by the legislative history, and a reviewing Court would most likely uphold the Finance Board's decision to create rules that permit multi-bank membership in the case of combinations.

## II. POLICY ISSUES

Permitting an institution that combines with another member to maintain the membership of the member that is acquired is in the best interest of the Bank System. There are many reasons in support of authorizing multi-bank membership in the case of combinations. Although there are arguments that can be raised to counter some of these reasons, the need to maintain an efficient and effective AHP program is so compelling that it demands authorizing multi-bank memberships in the case of combinations.

### Policy Arguments in Support of Multi-Bank Membership in the Context of Combinations:

#### a. Preserves a Balance in the Bank System.

No one Home Loan Bank will become disproportionate in size to the other Home Loan Banks if large members from several Home Loan Banks are acquired by the same out-of-district institution. This will also prevent the concentration of capital in any one part of the country. It will increase the probability that each Home Loan Bank will have the economies of scale necessary to maintain an efficient relationship with the capital markets and to support a minimum amount of operating expense.

<sup>1</sup> 12 C.F.R. Section 925.24.

<sup>2</sup> When a court reviews an agency's construction of the statute that it administers, it is confronted with two questions. First, always, is the question whether Congress has directly spoken to the precise question at issue. 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. If, however, 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 would be necessary in the absence of an administrative interpretation. Rather, 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. *Chevron*, 467 U.S. 837, 843.

Elaine L. Baker  
January 30, 2002  
Page 4 of 6

b. Provides for the Continued Access to AHP Funds.

Communities that were previously served by institutions that are acquired by an out-of-state institution would continue to have access to AHP funds. Experience suggests that markets that were previously served by institutions that are acquired by an out-of-state institution are not receiving the same access to AHP funds. This may be the result of Bank established limits on using AHP funds out-of-the-district or just a natural bias on behalf of members to look for projects closer to its home office. In any case, certain communities are being disadvantaged as a result of merger activities among members.

c. Reduces the Distortions Resulting from Bank Dollar Limits on AHP Funds.

Reduces the distortions in accessing AHP funds resulting from absolute dollar limits place on the amount any one member may access in any one year. These types of limits, which are permitted under current regulation and which are currently in place at some of the Home Loan Banks, limits the ability of acquiring member to serve the markets previously served by the acquired institution.

d. Provides for a More Efficient AHP Program.

Allows for local administration of AHP projects. The local Home Loan Bank is more familiar with the communities where the projects are located. Monitoring compliance will be more efficient if administered locally. AHP priorities are designed to meet the needs of communities in each Bank district. Accessing the AHP program of the Bank where the project is located will allow it to better qualify for funding because the project will have the characteristics required to meet the scoring priorities established by the Bank approving the application. In addition, all of the communities served by the member would have access to AHP programs that are designed to meet the needs of the communities served by the member.

e. Reduces the Amount of Credit Risk to any One Large Borrower.

Reduces the amount of advances any one Home Loan Bank would have outstanding to any one borrower. In addition, the credit risk to the capital market counterparty used to financially engineer the advances or the debt would be spread more evenly among the Home Loan Banks.

f. Reduces the Amount of Capital Concentrated in any Bank.

Reduces the amount of capital any one member would have to invest in any one Home Loan Bank. It would allow the member to diversify its investment in the Bank System.

g. Does Not Induce Competition Between the Banks.



Elaine L. Baker  
January 30, 2002  
Page 5 of 6

Members will not be able to threaten its Home Loan Bank that unless it receives more favorable terms and conditions, it will simply apply to join another Bank. If multi-bank membership is limited to cases involving combinations, the decision to maintain a membership in another Bank will be incidental to the combination and not be motivated by an attempt to obtain better terms and conditions of doing business with the Home Loan Bank System. The Banks already compete to some extent through both members that own separate charters in more than one district as well as in the fed funds market. The existing safeguards in both market realities and Federal Regulation prevent the Banks from engaging in unsafe and unsound competition with other Banks. A Bank cannot lower its advance rates below the level that will support a dividend that makes membership attractive to all members. In addition, the regulations require that the Banks operate in a safe and sound manner, which prevents the Banks from taking on undue risk (i.e., accepting low quality collateral, etc.) in order to be more competitive than other Banks.

- h. Prevents the Bank System from Being an Obstacle to an Otherwise Efficient Banking Organization.

Members were authorized to engage in full interstate banking in 1994. The Bank System has not updated its membership rules to conform with the new powers granted to its membership. The membership rules of the Bank System should be design to accommodate the members' business in order for membership to continue to be attractive to all institutions. The Members should not be required to maintain a separate charter, and incur the expense and inefficiency of that organizational structure, simply to maintain access to the Bank System. In addition, membership will be less attractive to current and prospective members if access to an AHP program designed to meet the needs of all of the communities served by the institution is impeded or denied because of out-of-date membership rules.

### III. OPERATIONAL ISSUES

Multi-bank membership will raise various operational issues and concerns. However, all of these issues can be adequately addressed through thoughtful regulation. To this end, we suggest the following rules regarding maintaining a membership after a combination.

#### A. Maximum Borrowing Amount

The institution that survives the combination may not receive credit from the Home Loan Bank of the acquired institution (hereinafter referred to as the "additional Home Loan Bank") in an amount that exceeds the lower of the average of the "maximum borrowing amounts" available to the acquired institution for the two year-ends immediately preceding the combination and the maximum borrowing amount on the date of the combination. The maximum borrowing amounts shall be determined by calculating the total dollar value of the acquired institution's qualifying collateral less any haircut assigned to that collateral. The averaging requirement is intended to prevent an acquirer from gaming the limit by moving a large amount of qualifying collateral into the acquired institution immediately prior to the combination.

Elaine L. Baker  
January 30, 2002  
Page 6 of 6

B. Intercreditor Agreement

Each Home Loan Bank shall enter into an intercreditor agreement with the other Home Loan Banks that provides for a subordination of the security interest in an amount of collateral used to calculate the maximum borrowing amount of any acquired institutions. The intercreditor agreement shall provide that the acquiring member shall be permitted to designate the amount of collateral that is pledged to each Home Loan Bank that it is a member. Thus, the acquiring member can reduce the amount it can borrow from a Home Loan Bank in which it maintains an "additional" membership, but it may not increase its maximum borrowing amount by assigning new or additional collateral under the intercreditor agreement.

C. Capital Stock

The surviving institution shall purchase membership-based stock in the additional Home Loan Bank based on the higher of the average asset size of the acquired institution on December 31<sup>st</sup> of the previous two years and the asset size of the acquired institution on the date of the combination. This would apply irrespective of whether the membership stock requirement is calculated on total assets, mortgage assets, or some other asset base. The assets of the acquired institution shall be subtracted from the amount of assets used to calculate the membership-based stock purchased in any other Home Loan Bank where the institution maintains a membership. The activity-based stock requirement shall be calculated based on the amount of the relevant activity that is being conducted with the additional Home Loan Bank.

D. Election of Directors

The surviving institution shall be authorized to vote in the election of directors in the state where the acquired institution voted. The surviving institution shall have the same rights and privileges as any other member voting in that state. An officer or director of the surviving institution may serve on the Board of Directors of the additional Home Loan Bank so long as he or she meets all of the eligibility requirements (i.e., residency, etc.) for such position.

IV. REGULATORY PROCESS

The Pittsburgh Bank does not support the Finance Board addressing the issues involved in multi-bank membership through the petition process set forth in section 907.10 of the Rules and Regulations. Instead, the Finance Board should only address the issues raised by multi-bank membership through the formal rule making process. This approach will more likely result in a level playing field for all members of the Bank System.

Please contact Dana A. Yealy, Senior Vice President and General Counsel, at (412) 288-2833 if you have any questions or need additional information.

Sincerely,

