The Federal Home Loan Banks (FHLBanks)
Business and Funding Fundamentals

Key Points

- The FHLBanks are a source of stability in the U.S. financial system.
- They are risk-averse, well-capitalized cooperatives that have never experienced a loss on their collateralized lending to member institutions.
- The FHLBanks help keep credit affordable and available to millions of Americans every day.

Background

The FHLBanks play a vitally important role in the U.S. financial system. Their purpose is to provide reliable liquidity to member institutions to support housing finance and community investment. Lendable funds from the FHLBanks help U.S. lenders invest in local needs including housing, jobs and economic growth. It is the mission that the FHLBanks have carried out with a steady hand for 86 years, in good and bad economic times.

Eleven regional FHLBanks cover every state and territory of the nation. Congress chartered the FHLBanks as cooperatives. That means FHLBank member institutions are both their owners and customers. Their approximately 7,000 members are lenders of all sizes and types, including community banks, credit unions, commercial and savings banks, insurance companies and community development financial institutions.

The FHLBanks obtain capital by borrowing from investors around the world and then lend those funds to their members on a secured basis. The FHLBanks are a primary way that thousands of U.S. financial institutions can access the global credit markets and be assured of having money to lend in all economic cycles. The regional structure of the FHLBanks gives them the ability to respond to local needs throughout the entire country.

How the FHLBanks Operate Within a Safe and Sound Business Model

The FHLBanks' conservative business model has kept them operating as a reliable partner for their members through every downturn, including the 2008 financial crisis.

In fact, as the Federal Reserve Bank of New York noted amid the crisis in a November 2008 report, *"The often-overlooked FHLB System was one of the first institutions to emerge as an important provider of government-sponsored liquidity … Without the FHLB System, the Federal Reserve likely would have faced significant demand for borrowing at the Discount Window at a much earlier stage of the crisis."*

The FHLBanks have a very low risk profile. They operate under a narrow federal charter and the supervision of a strong regulator, the Federal Housing Finance Agency (FHFA), whose powers were enhanced by Congress in 2008. The FHFA closely supervises the 11 FHLBanks, which are subject to annual stress tests mandated by the Dodd-Frank Act. These tests are done under the direction of the FHFA and are based on the challenging stress test scenarios used by the Federal Reserve. The FHLBanks have always passed the tests.

The cooperative structure of the 11 FHLBanks is source of their reliability and strength. The System is stronger because all FHLBanks are jointly obligated for the repayment of debt known as "consolidated obligations."

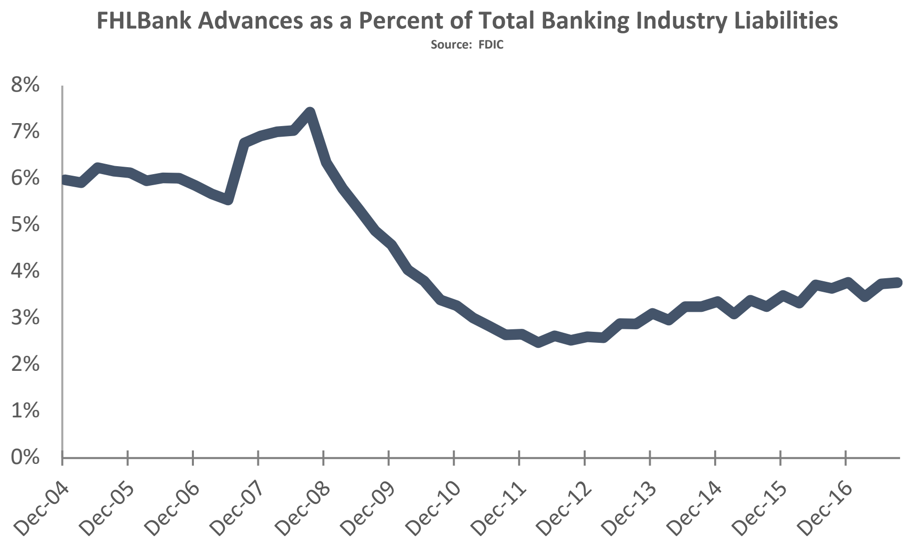
The FHLBanks have never taken a credit loss on a loan to a member (loans to FHLBank members are called "advances"). By law, the FHLBanks can only lend to member institutions on a fully secured basis using very conservative collateral practices. Credit risk is minimized by the close monitoring of a member's financial health and continuous monitoring of collateral coverage. The regional aspect of the FHLBank System ensures that each FHLBank is familiar not only with each of its members, but the specific environment in which they operate – thereby creating an additional layer of risk management.

Another feature of the FHLBank model is the regulatory requirement to communicate and work with a member's regulator should that member weaken financially. Under FHFA regulation, when a member gets into financial difficulty, a FHLBank can only lend to that member with the consent of that member's regulator.

The FHLBanks' conservative and well-regulated approach to credit risk, combined with a cooperative structure, results in the FHLBanks' low-risk balance sheet. Approximately 65 percent of FHLBanks' assets are over-collateralized loans to their members. The remaining 35 percent are high-quality, low-risk assets.

The FHLBanks' have four percent statutory minimum capital ratios, requirements that are consistent with the low-risk lending model and reflect the mitigation of credit risk on the balance sheet. In addition, theirs is a self-capitalizing business model. That means as members borrow more, they are required to purchase more capital stock from their FHLBanks. This is another important risk mitigant in the FHLBank model that is unique. Finally, the FHFA has the authority to increase those capital requirements if it deems it necessary.

At the end of the third quarter of 2017, more than 4,000 financial institutions of all sizes actively borrowed from the FHLBanks. Outstanding advances with the top 10 borrowers have not significantly changed as a percentage of total advances since the financial crisis. As bank liabilities have grown from $9 trillion in 2005 to more than $15 trillion today, the percentage of advances to liabilities has not returned to pre-crisis levels, according the FDIC. At the end of the third quarter of 2017, FHLBank lending to the nation's five largest banks represented only 2.5 percent of the liabilities of those institutions.



The Debt Profile and Funding Strategy

FHLBanks maintain a broad and flexible suite of debt products to meet the changing needs of both members and investors. Their debt issuance is driven by the types of advances their members seek and influenced by shifting investor demands for different debt products.

The funding strategies used by the FHLBanks allow them to do two important things: 1) obtain funding at lower costs, which are passed on to member institutions, and; 2) provide reliable liquidity to members by maintaining access to the global credit markets. Together this helps keep credit affordable and available to millions of Americans every day.

While the FHLBanks' debt profile has shortened recently, the demand from members for advances has similarly changed in the last few years. Members have increasingly looked for shorter duration funding that is reflected in the growth of floating rate and pre-payable advances. Additionally, the FHLBanks maintain a liquidity portfolio of very short-term, high-quality investments for regulatory purposes and member liquidity needs. This portfolio is funded with short duration debt.

Moreover, assets that are less than one-year in maturity represent approximately 50 percent of total assets. More than 50 percent of assets are variable rate or very short-term. Given the increase in the short-term contractual maturities, shorter duration member funding and the variable rate structures of many advances, it is appropriate to fund these assets with short duration debt.

Central to the FHLBanks' successful funding is their deep and diverse investor base. The current debt investor base is near evenly split between money market funds and many other non-money funds. That has not always been the case. In fact, other investors such as state and local treasurers, financial institutions, corporations, insurance companies, pension funds, foreign central banks and other international investors held a larger percentage of FHLBank securities before the implementation of money market reform in October 2016.

Conclusion

The FHLBanks promote stability in the financial system. The steady supply of lendable funds from the 11 regional FHLBanks helps financial institutions invest locally in housing, jobs and economic growth. The FHLBanks are an important way that U.S. lenders access the global credit markets and are assured of having money to lend in all economic cycles. They are low-risk, well-capitalized, financially strong institutions. Working with their members, these 11 regional cooperatives support every community of the country every day --- and do it in a safe and sound manner. The FHLBanks are a model that works.

March 2018