A Tool In The Toolbox - History Of The FHLB

by Steve Brown

Almost every bank has used Federal Home Loan Bank (FHLB) advances to meet its funding needs at times. It is a time-honored liquidity option not only for banks but other insured financial institutions. Congress chartered the FHLBank System in 1932 to provide liquidity to member financial institutions to assist in financing housing and other community lending.

The 12 banks of the FHLB are structured as cooperatives and are owned and governed by member financial institutions. Members include large banks, community banks, thrifts and credit unions and total more than 7,500 regulated financial institutions. Institutions are required to purchase stock in order to become members and in return have access to low-cost funding, as well as receiving dividends. Members typically use FHLB borrowings to finance loans in their market footprints.

Originally, the Federal Home Loan Bank Act of 1932 provided funds for "building and loan associations" which later became S&Ls, or thrifts. After the S&L crisis of the 1980s, authority for the FHLB banks was passed to the Office of Thrift Supervision (OTS). At that time, insured financial institutions (other than thrifts) including commercial banks and credit unions, were allowed to join the FHLB system. The Dodd-Frank Act mandated that the OTS merge with the OCC, the FDIC, the FRB and the CFPB, and at this point supervisory authority over the FHLB became a part of the Federal Housing Finance Agency (FHFA).

FHLB advances are an important part of any bank's liquidity tool kit. In any tool kit, certain tools are appropriate and useful for some tasks and not so much for others. If tweezers are the best tool for a particular task, grabbing a hammer from the tool box probably won't help much.

What about the idea of locking in longer term FHLB advances now? After all, rates are only going to be higher later on and FHLB advances are a relatively inexpensive source of funding. Isn't it better to lock in today's low rates now? At first glance this may seem like a logical path. Taking a closer look though, if your bank locks in longer term advances now, those funding costs are likely significantly higher than the current funding costs in your bank. Given that most banks have a lot of liquidity and also have the lowest funding costs anyone can remember, this path probably doesn't make sense in most situations. Locking in longer term advances raises the bank's funding costs now. Consider that given the long period of low interest rates, had a bank taken this action 2Ys ago, they probably would have compromised their margins for that entire time. The future of FOMC rate hikes is uncertain and no one knows how quickly deposit rates will move.

In speaking with bankers who have seen examiners recently, many have reported particular concern among regulators over "surge deposits" that could possibly leave the bank the moment interest rates rise and more attractive alternatives are available elsewhere. We tend to think this fear is overblown for most community banks, but clearly regulator concerns need to be addressed. Demonstrating a history of deposit behavior from previous periods of rising interest rates may be helpful, but so is having liquidity alternatives like the availability of FHLB advances.

Community banks and the FHLB are historically intertwined and co-dependent. Our advice is to judiciously use the tools the FHLB provides to help your bank succeed, while you remember that not every tool is perfect for every task, so analyze your options, risks and any potential impact before you determine which one to select for which task.

BANK NEWS

Retiring

Fed Philadelphia President Plosser has announced he will retire effective March 1, 2015. He has been president since 2006.

Class Action

Glancy Binkow & Goldberg LLP announced a class action lawsuit has been filed against Bankrate, Inc. alleging the Company misrepresented and/or failed to disclose that its financial statements contained errors related to improper recognition of revenue and expenses (and its internal controls over financial reporting were inadequate). On September 14 Bankrate's audit committee said financial statements for 2011, 2012 and 2013 should no longer be relied upon and on September 15 it announced that its CFO had resigned and that the SEC was now conducting a formal investigation into its financial reporting.

Spooky Cyber

Wired reports that a cybercrime ring targeted and hacked more than 300 banks, governments and research facilities for about 12 years before the group was discovered and shut down.

Friends and Family

The National Association of Realtors reports in 2013 about 27% of people who purchased their first home received a cash gift from relatives or friends to help with the down payment vs. 24% in 2012. This is the highest percentage on record.

Big Mistake

Bloomberg reports Home Depot's in-store payment system wasn't set up to encrypt customer credit or debit card information.

Money Advice

TD Ameritrade reports Gen Z (ages 15 to 24) turn first to their parents for financial advice (50%) vs. 10% from teachers or school and 57% indicate saving money is very important to them.

Better

CoreLogic reports the percent of mortgaged homes with negative equity has declined to 12.7%.

Huge Market

Bloomberg reports foreign exchange trading by banks amounts to about $5.3T per day.