

Federal Housing Finance Board

Memorandum

March 5, 1992

TO: Philip L. Conover
Deputy Executive Director

Thomas D. Sheehan, Assistant Director,
Financial Division, District Banks Directorate

FROM: Beth L. Climo
General Counsell *BLC*

SUBJECT: Unilateral Retirement Of FHLBank Stock

In commenting on the Finance Board's proposed rule on FHLBank dividends, the FHLBank-Pittsburgh recommended that the final rule provide the FHLBanks with the authority to unilaterally retire stock that exceeds the amount required as collateral for advances. The FHLBanks currently may redeem excess stock only at the request of the member. In response to this comment, the Finance Board stated that it would take under advisement the possibility of addressing this issue by rulemaking.

We have prepared the attached opinion which concludes that a reasonable interpretation of the Bank Act would allow the Finance Board to issue a rule authorizing the FHLBanks to unilaterally retire FHLBank stock that exceeds the advances-to-stock requirements due to a decrease in outstanding advances. If the Finance Board decides to address this issue by rulemaking, we suggest the advances regulation would be the appropriate vehicle.

Attachment

cc: Renie Y. Grohl
James H. Gray
Jon E. Boustany

Federal Housing Finance Board

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TO: Philip L. Conover
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General Counsel

SUBJECT: Unilateral Retirement of FHLBank Stock

We have been asked by the District Banks Directorate to address the following issue regarding the Federal Home Loan Banks' ("FHLBanks'") authority to redeem stock in excess of stock purchase requirements.

ISSUE: Whether the Federal Housing Finance Board ("Finance Board") may issue a rule authorizing the FHLBanks, in their discretion, to unilaterally retire FHLBank stock.

CONCLUSION:

The Finance Board may issue a rule authorizing the FHLBanks to unilaterally retire FHLBank stock purchased to support advances when the stock exceeds the amount the member is required to hold as collateral for advances.

I. BACKGROUND

Currently, the FHLBanks annually recalculate a member's minimum required stockholdings. Members holding stock in excess of this recalculated amount may redeem the excess stock. However, the FHLBanks obtain an application from the member before retiring any excess stock. Consequently, a member may choose to hold rather than redeem such excess stock holdings. The FHLBanks have never forced members to redeem these excess holdings.

In commenting on the Finance Board's proposed rule on FHLBank dividends, the FHLBank-Pittsburgh cautioned that the changes made by the rule may result in excess FHLBank stock becoming an alternative to other short-term investments in view of the fact that the FHLBanks currently may redeem excess stock only at the request of the member. See 56 Fed. Reg. 59898 (Nov. 26, 1991). The FHLBank-Pittsburgh warned that some members may "take a large overnight loan, buy additional stock, pay off the loan the following day and hold the excess stock to reap the dividend." This practice would make it difficult for a FHLBank to manage its equity.

The FHLBank-Pittsburgh suggested that the final rule on the payment of dividends address this issue by providing the FHLBanks with the option of unilaterally redeeming excess stock. In response to this comment, the Finance Board stated that it would take under advisement the possibility of addressing this issue by rulemaking.

II. THE FINANCE BOARD HAY ISSUE A RULE AUTHORIZING FHLBANKS TO UNILATERALLY REDEEM FHLBANK STOCK IN EXCESS OF THE AMOUNT REQUIRED AS COLLATERAL FOR OUTSTANDING ADVANCES

A. The Amount Of Stock Required To Be Maintained By Members Under The Bank Act

Subparagraph 6(b)(1) of the Federal Home Loan Bank Act ("Bank Act") requires all members to purchase stock equal to one percent of the member's "aggregate unpaid loan principal,"¹ but not less than \$500 ("one percent minimum stock purchase"). 12 U.S.C. § 1426(b)(1) (Supp. I 1989). Also, subparagraph 10(e)(3) requires each member to purchase FHLBank stock as if at least 30 percent of its assets consist of home mortgage loans. 12 U.S.C. § 1430(e)(3) (Supp. I 1989). (These two requirements will be referred to herein as "minimum subscription requirements.")

In addition to the minimum subscription requirements, the Bank Act has two stock purchase requirements based on outstanding advances. (These requirements will be referred to herein as the "advances-to-stock requirements"). Subsection 10(c) of the Bank Act requires members to maintain stock equal to at least five percent of outstanding advances.² Thus, as a member increases the amount of its borrowings from its FHLBank, it is required to purchase additional stock.

Furthermore, under subparagraph 10(e)(l) of the Bank Act,

1. The tern 'aggregate unpaid loan principal' is defined as the aggregate unpaid principal of a subscriber's home mortgage loans, home purchase contracts and similar obligations. See 12 U.S.C. § 1426(b)(4) (Supp. I 1989).

2. Subsection 10(c) of the Bank Act provides in pertinent part:

At no time shall the aggregate outstanding advances made by any Federal Home Loan Bank to any member exceed twenty times the amounts paid in by such member for outstanding capital stock held by it exceed twenty times the value of the security required to be deposited under section 6(e). [sic]

12 U.S.C. § 1430(c) (Supp. I 1989).

a member that is not a "qualified thrift lender" (a "non-QTL member")³ must maintain stock equal to at least five percent of its total advances divided by such member's actual thrift investment percentage.⁴ Id. Accordingly, non-QTL members must purchase more stock than QTL members in order to take out the same amount of advances.

B. The Bank Act Authorizes The FHLBanks To Retire FHLBank Stock Held By Its Members Under Subparagraph 6(b)(1) And Subsection 6(e)

1. Annual adjustment of FHLBank stock in excess of minimum subscription requirements

The Bank Act explicitly authorizes the FHLBanks to retire FHLBank stock held by their members in two instances. In the first instance, subparagraph 6(b)(1) directs the FHLBanks at the end of each calendar year to recalculate a member's minimum subscription requirements and adjust its stockholdings. In making these annual adjustments, the FHLBanks are authorized,

3. In order to have QTL status, a savings association's qualified thrift investments ("QTIs") must equal or exceed 65 percent of the savings association's portfolio assets on a month average basis in nine out of every twelve months. See Federal Deposit Insurance Corporation Improvement Act of 1991, Pub. L. No. 102-242, § 437, 105 Stat. 2236 (December 19, 1991) ("FDICIA"). QTIs include inter alia loans, equity positions or securities by mortgages, which are related to domestic real estate or manufactured housing. See 12 U.S.C. § 1467(m)(4)(b) (1991) as amended by the FDICIA. FHLBank members that have 65 percent of their portfolio assets in QTIs are considered QTL members.
4. "Actual thrift investment percentage" is defined as the amount of an institution's QTIs divided by the total amount of the institution's tangible assets. See 12 U.S.C. § 1430(e), which states that the term "actual thrift investment percentage" has the same meaning as in subsection 10(m) of the Home Owners' Loan Act ("HOLA").
5. The second sentence of subparagraph 6(b)(1) provides:

The bank shall annually, as of the close of the calendar year, adjust, at such time and in such manner and upon such terms and conditions as the [Finance] Board may by regulations or otherwise prescribe, the amount of stock held by each member so that such member shall have invested in the stock of the [FHLBank] at least an amount [equal to its minimum stock subscription].

12 U.S.C. § 1426(b)(1) (Supp. I 1989).

subject to certain conditions, to retire a member's FHLBank stock when the member's stock holdings exceed the minimum subscription requirements. See 12 U.S.C. § 1426(b)(1) (Supp. I 1989). The third sentence of subparagraph 6(b)(1) states:

If the bank finds that the investment of any member in stock is greater than the amount required under this subsection, it may, unless prohibited by [the Finance] Board or by the provisions of paragraph (2) of this subsection, in its discretion and upon application of such member retire the stock of such member in excess of the amount so required.

Id. (Emphasis added).

The emphasized language indicates that the FHLBanks must obtain the "application" of a member prior to retiring excess stock. However, it appears that this provision is expressly limited to the annual adjustment of a member's stockholdings to ensure compliance with the minimum subscription requirements. When read together, the provisions of subparagraph 6(b)(1) spell out the mechanism by which a FHLBank is to ensure that its members are in compliance with the minimum subscription requirements.⁶ Therefore, the scope of the requirement that stock retirement be made "upon application of [a] member" would appear to be limited to situations where a FHLBank is annually adjusting its members' stock holdings to comply with the minimum subscription requirements. Arguably, it does not apply to situations where a FHLBank is retiring stock in excess of the advances-to-stock requirements.

2) Retirement of FHLBank stock upon termination of membership

The second situation in which the Bank Act expressly authorizes the FHLBanks to retire FHLBank stock is upon termination of the stockholder's membership in the Federal Home Loan Bank System ("FHLBank System"). Subsection 6(e) provides in pertinent part:

If any member's membership in a [FHLBank] is terminated, the indebtedness of such member to the [FHLBank] shall be liquidated in an orderly manner (as determined by the [FHLBank]), and upon completion of such liquidation, the capital stock in the [FHLBank] owned by such member shall be surrendered and canceled. (Emphasis added).

6. It is a fundamental rule of statutory construction that each part of a statute should be construed in connection with every other part so as to produce a harmonious whole. See 2A N. Singer, Sutherland Statutory Construction § 46.053 103 (Sands 4th ed. 1984).

12 U.S.C. § 1426(e) (Supp. I 1989).

Subsection 6(e) contains no language precluding the FHLBanks from retiring an existing member's FHLBank stock, which exceeds the advances-to-stock requirements. Furthermore, in an opinion dated June 14, 1991, the Office of General Counsel ("OGC") of the Finance Board concluded that the emphasized language in subsection 6(e) authorizes the FHLBanks, upon termination of a stockholder's membership, to unilaterally redeem all the stockholder's FHLBank stock, if it owes no outstanding indebtedness to the FHLBank. See Opin. Gen. Couns. Finance Board (June 14, 1991). Thus, there are situations in which the FHLBanks are expressly authorized to unilaterally redeem a shareholder's FHLBank stock.

C. The Finance Board May Issue The Proposed Rule If The Rule Is Based On A Reasonable Interpretation Of The Bank Act

Congress has delegated to the Finance Board broad authority to issue rules to carry out the provisions of the Bank Act. See id. § 1422b(a)(1) (Supp. I 1989). Subparagraph 2B(a)(1) of the Bank Act states that the Finance Board shall have the power to "promulgate and enforce such regulations and orders as are necessary from time to time to carry out the provisions of this chapter." Id.

However, the Finance Board may not use unbridled discretion when construing the provisions of the Bank Act, but must adhere to the intent of Congress. The United States Supreme Court, *in Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), set forth the parameters of an administrative agency's authority to construe the statutes it administers. First, if **Congress** has directly spoken on the precise question at issue, the agency is bound to give effect to the expressed intent of **Congress**. Id. at 843. However, if a statute is silent or ambiguous on a specific issue, the agency's answer must be based on a permissible construction of the statute. Id. at 844. The Supreme Court recognized that an administrative agency's power to administer its statutes "necessarily requires the formulation of policy and the making of rules to fill any gap left, implicitly or explicitly, by Congress." Id. (quoting *Morton v. Ruiz*, 415 U.S. 199, 231, 94 S.Ct. 1055, 1072 39 L.Ed.2d 270 (1974)). If Congress has explicitly left a gap for the agency to fill, an agency's construction will be given controlling weight unless it is arbitrary, capricious, or manifestly contrary to the statute. Id. When such legislative delegation is implicit, the agency's construction must be a reasonable interpretation of the statute. Id. at 845.

The Bank Act does not expressly address the question of whether the FHLBanks are authorized to unilaterally retire stock held in excess of advances-to-stock requirements. See 12 U.S.C. §§ 1426(b)(1), 1430(e)(3) (Supp. I 1989). Further, a search of

the legislative history of these provisions reveals no evidence indicating Congressional intent as to this issue. Thus, under the Supreme Court's test in Chevron, the Finance Board's construction of the Bank Act must be a reasonable interpretation of the statute.

VI. CONCLUSION

The Bank Act expressly authorizes the FHLBanks to retire a member institution's FHLBank stock in subparagraph 6(b)(1) and subsection 6(e). See 12 U.S.C. § 1430(c), (e)(Supp. I 1989). Neither of these provisions expressly forecloses the FHLBanks' authority to unilaterally retire stock held by members in excess of the advances-to-stock requirements. See *id.* at § 1430(c)(Supp. I 1989). In fact, the FHLBanks currently redeem stock in excess of the advances-to-stock requirements throughout the year when advances are repaid, at the request of a member. A rule granting the FHLBanks the discretion to unilaterally redeem FHLBank stock in excess of the advances-to-stock requirements would not contravene the language of subparagraph 6(b)(1) that conditions retirement of FHLBank stock upon application of the stockholder. That condition only applies when a FHLBank is adjusting a member's stock holdings to ensure annual compliance with the minimum subscription requirements.

Congress has not explicitly addressed the issue of whether a FHLBank has the authority to retire FHLBank stock held by its members in excess of the advances-to-stock requirements. In the absence of an express intent of Congress on the issue, the Finance Board may issue a rule giving the FHLBanks such authority as long as the rule is a reasonable interpretation of the Bank Act. See Chevron, 467 U.S. at 843-44 (1984). We believe a rule authorizing the FHLBanks to unilaterally retire FHLBank stock which is in excess of the advances-to-stock requirements due to a decrease in outstanding advances would be a reasonable interpretation of the Bank Act.



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