



Federal Housing Finance Board

April 13, 1992

MEMORANDUM

TO: Philip L. Conover
Deputy Executive Director

FROM: Beth L. Climo *BLC*
General Counsel

SUBJECT: Opinion on Risk-Based Pricing of Advances

Attached is a copy of the opinion we have prepared in response to the January 2, 1992 letter from Jill Spencer requesting guidance on whether a risk-based advance pricing program is consistent with the non-discrimination requirement in subsection 7(j) of the Bank Act. Our opinion concludes that risk-based advance pricing does not constitute discrimination and therefore is consistent with the requirements of subsection 7(j).

We hope that this opinion is useful in your development of the advances regulations.

Attachment

cc: J. Stephen Britt
Gary B. Townsend
Thomas D. Sheehan
Christine Freidel



Federal Housing Finance Board

April 13, 1992

MEMORANDUM

TO: Philip L. Conover
Deputy Executive Director

FROM: Beth L. Climo
General Counsel

SUBJECT: Risk-Based Pricing Program for Federal Home Loan
Bank Advances

ISSUE:

Whether subsection 7(j) of the Federal Home Loan Bank Act ("Bank Act"),¹ which requires that FHLBank directors act without discrimination against any member borrower in the Federal Home Loan Bank System ("FHLBank System"), prohibits a Federal Home Loan Bank ("FHLBank") from extending credit to members on different terms based on the members' respective creditworthiness.

CONCLUSION:

The requirement of Bank Act subsection 7(j) that FHLBank directors act "without discrimination" ("non-discrimination requirement") does not preclude a FHLBank from extending credit to members on different terms based on the members' respective creditworthiness because such a practice is consistent with the FHLBanks' broad discretion to make advances under Bank Act section 9.

DISCUSSION:

Background

In a letter dated January 2, 1992, the FHLBank-San Francisco asked the Office of General Counsel of the Federal Housing Finance Board ("Finance Board") to prepare an opinion

1. Pub. L. No. 304, ch. 522, § 7(i), 47 Stat. 725, 731 (1932) (codified as amended at 12 U.S.C. § 1427(j) (Supp. I 1989)).

regarding the impact of Bank Act subsection 7(j) on a FHLBank's ability to impose different borrowing terms on its members, based on the members' respective creditworthiness. See 12 U.S.C. § 1427(j) (Supp. I 1989). This opinion concludes that the requirement in subsection 7(j) that FHLBank directors act "without discrimination" does not prohibit the extension of credit to members based on their respective creditworthiness.
rd.

The plain Meaning And Legislative History Of Bank Act
Subsection 7(j)

Subsection 7(j) of the Bank Act requires that each FHLBank board of directors "shall administer the affairs of the bank fairly and impartially and without discrimination in favor of or against any member borrower . . ." 12 U.S.C. § 1427(j) (Supp. I 1989) (emphasis added). We interpret the above quoted language of subsection 7(j) as imposing two distinct duties on a FHLBank board of directors. First, each board generally must administer the affairs of the FHLBank fairly and impartially. Second, the board must act without discrimination in favor of or against any member borrower.² This opinion addresses only the issue of whether a FHLBank's extension of credit to members based on their respective creditworthiness is consistent with the second duty -- to act without discrimination towards any member borrower.

While subsection 7(j) on its face requires that the directors of a FHLBank conduct the affairs of the FHLBank "without discrimination" towards any borrower, id., the precise nature of the standard of conduct this language imposes is not specified. The term "discrimination" is not defined in the Bank Act.³ See id. § 1422. Further, we found no discussion of

2. Our interpretation of subsection 7(j) is supported by the fundamental rule of statutory construction that states that "[r]eferential and qualifying words and phrases . . . refer solely to the last antecedent," where no contrary intention appears. See 2A N. Singer, Sutherland Statutory Construction § 47.33, at 270 (Sands 4th ed. 1984). In subsection 7(j), the qualifying phrase, "in favor of or against any member borrower" modifies only the words "without discrimination." Thus, a FHLBank board's duty to administer FHLBank affairs "fairly and impartially" is a general duty, not modified by the qualifying phrase, "in favor of or against any member borrower."

3. The Finance Board has neither promulgated a regulation nor issued a legal opinion interpreting the term "discrimination" in subsection 7(j). However, the General Counsel of the former Federal Home Loan Bank Board ("Bank Board") issued an opinion in 1966 concluding that a FHLBank would not violate the non-discrimination requirement of subsection 7(j) by charging

the applicable standard in the legislative history of the Bank Act. The Federal Reserve Act⁴ contains a non-discrimination requirement similar to that in Bank Act subsection 7(j), see 12 U.S.C. § 301 (1988), however the legislative history of the Federal Reserve Act does not clarify the standard that its requirement imposes. Nor have we found any cases that interpret the Federal Reserve Act's non-discrimination requirement.

Judicial Interpretation Of Subsection 7(j)

We are aware of only one case interpreting the non-discrimination requirement of subsection 7(j). In Fidelity Financial Corp. v. Federal Home Loan Bank of San Francisco, 589 F. Supp. 885 (N.D. Cal. 1983), aff'd, 792 F.2d 432 (9th Cir. 1986), cert. denied, 479 U.S. 1064 (1987), Fidelity Financial Corporation, the parent company of Fidelity Savings and Loan Association, San Francisco, California ("Fidelity"), challenged the authority of the FHLBank-San Francisco to place Fidelity in the FHLBank's Other Special Credit ("OSC") program. See id. at 889. The FHLBank-San Francisco placed members in the OSC program if they failed to meet certain credit criteria for the regular advances program. Those members in the OSC program were charged a rate of interest two percent higher than those in the regular program and were subject to other restrictions on the availability of advances. Id. Fidelity sued the FHLBank-San Francisco for damages alleged to have resulted from the FHLBank's placement of Fidelity in the OSC program. Id.

In its suit in federal district court, Fidelity asserted several causes of action, including a claim that it had a constitutionally protected property interest in receiving advances under the FHLBank-San Francisco's regular lending program. The court rejected this claim on the ground that section 9 and subsection 7(j), when read together, confer upon the FHLBanks "plenary" discretion to exercise their lending policies. Id. at 897. In reaching this conclusion, the court looked to both section 9 and subsection 7(j) of the Bank Act.⁵ Section 9 states that:

(Footnote 3 continued from previous page)
variable interest rates on advances made for different purposes, as long as the FHLBank's board of directors was not improperly motivated. See Op. Gen. Couns. Fed. Home Loan Bank Bd. 3 (June 30, 1966).

4. Rub. L. No. 43, § 4, 38 Stat. 251 (1913) (codified at 12 U.S.C. § 221 et seq. (1988)).

5. The language of subsections 9 and 7(j) that the court referred to in Fidelity is the same language in effect under the current version of the Bank Act. See 12 U.S.C. §§ 1427(j), 1429 (Supp. I 1989).

Any member borrower of a Federal Home Loan Bank shall be entitled to apply in writing for advances Such Federal Home Loan Bank may in its discretion deny any such application, or, subject to the approval of the Board, may grant it on such conditions as the Federal Home Loan Bank may prescribe.

12 U.S.C. § 1429 (Supp. I 1989) (emphasis added). The court found that the grant of discretion to make advances set forth in section 9 would be eviscerated if subsection 7(j) were read to bar the FHLBanks from creating different lending terms to suit the varying creditworthiness of member borrowers. See Fidelity 589 F. Supp. at 897 (N.D. Cal. 1983). The court stated that:

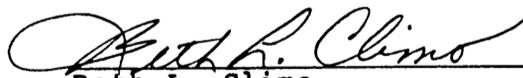
A fairer reading of the Bank Act, particularly §§ 7(j) and 9 in toto, compels the conclusion that the Bank had discretion to establish variable credit terms, subject to its statutory obligations [T]he effect of §§ 7(j) and 9 is to confer plenary discretion upon the Bank to establish and implement its lending policies.

Id. Implicit in the court's conclusion is a determination that the non-discrimination requirement in subsection 7(j) does not preclude a FHLBank from establishing variable credit terms for different members based on their respective creditworthiness.

In affirming the district court on appeal, the Ninth Circuit did not specifically address the district court's interpretation of subsection 7(j). It noted merely that subsection 7(j) did not significantly constrain the FHLBanks' discretion to deny or condition advances. See Fidelity Financial Corp. v. Federal Home Loan Bank of San Francisco, 792 F.2d 1432 (9th Cir. 1986), cert. denied 479 U.S. 1064 (1987).

CONCLUSION:

The non-discrimination requirement of Bank Act subsection 7(j) does not preclude a FHLBank from extending credit to FHLBank members on different terms based on the members' respective creditworthiness because such a practice is consistent with the FHLBanks' broad discretion to make advances under Bank Act section 9.


Beth L. Climo