



Federal Housing Finance Board

October 16, 1998

MEMORANDUM

TO: Bruce A. Morrison
Chairman

THROUGH: Deborah F. Silberman *DFS*
General Counsel

FROM: Janice A. Kaye *JK*
Attorney-Advisor

SUBJECT: Effect of the Statutory Purpose Limitation on
the FHLBanks Authority to Invest in SBICs

ISSUE:

The meaning of the phrase “for the purpose of aiding members of the Federal Home Loan Bank [FHLBank] System” under the portion of section 11(h) of the Federal Home Loan Bank Act (Bank Act) dealing with the FHLBanks’ authority to invest in small business investment companies (SBICs).

CONCLUSION:

Neither the plain language of section 11(h) of the Bank Act nor the most recent legislative history of the limiting phrase “for the purpose of aiding members of the [FHL]Bank System” clearly explains the meaning of the phrase. Therefore, the Federal Housing Finance Board (Finance Board) has discretion to interpret the statute to further the intent of Congress in deciding whether a FHLBank’s investment in an SBIC aids FHLBank members.

DISCUSSION:

I. BACKGROUND

An SBIC is a corporation, limited liability company, or limited partnership created under state law and licensed by the Small Business Administration (SBA) under the Small Business Investment Act of 1958 (Investment Act) solely to act as an SBIC. 15 U.S.C.A. § 681(a) (West 1997). The purpose of an SBIC is to provide a source of equity capital for and to make loans to

small business concerns.¹ The SBA assists SBICs by providing “leverage,” that is, it purchases or guarantees the payment of principal and interest on debentures or participating securities issued by an SBIC. 15 U.S.C.A. §§ 662(1) and 683(b) (West 1997 and Supp. 1998).

Section 11(h) of the Bank Act authorizes a FHLBank to invest in SBICs. See 12 U.S.C.A. § 1431(h) (West 1989 and Supp. 1998). In pertinent part, section 11(h) provides that to the extent a FHLBank deems it desirable and subject to any regulations, restrictions, or limitations the Finance Board may prescribe, a FHLBank may invest surplus funds (funds not required for reserves or for advances to members) in stock, obligations, or other securities of any SBIC formed pursuant to section 301 of the Investment Act, “for the purpose of aiding members of the [FHL]Bank System.” *Id.*; 15 U.S.C.A. § 681 (West 1997 and Supp. 1998).

Under the authority provided by section 11(h) of the Bank Act, the FHLBank of [REDACTED] **has requested Finance Board** approval to purchase a limited partnership interest in [REDACTED], an SBIC that will invest primarily in technology and **telecommunication companies in the** Midwest and California. In connection with them [REDACTED] request, a question has arisen concerning the meaning of the limiting phrase “for the purpose of aiding members of the [FHL]Bank System” as used in section 11(h).

II. ANALYSIS

It is a fundamental rule of statutory construction that the words of a statute be interpreted according to their plain and ordinary meaning. See 2A N. SINGER, SUTHERLAND STATUTES AND STATUTORY CONSTRUCTION § 46.01 (5th ed. 1992). Thus, the starting point for ascertaining the meaning of a statutory phrase is the language of the statute itself. However, when the meaning of a statute is not clear and unambiguous on its face, the purposes for which legislation was passed may be determined by looking to its legislative history. See *id.* § 46.05. It is a basic principle of statutory construction that statutes be interpreted to promote the purpose for which legislation was passed. See *id.* §§ 46.02 and 46.05.

The meaning of the limiting phrase “for the purpose of aiding members of the [FHL]Bank System” is not clear on its face. As used in section 11(h) of the Bank Act, the phrase could mean that the FHLBanks only have authority to invest in SBICs that are “formed . . . for the purpose of aiding members.” 12 U.S.C.A. § 1431(h) (West 1989 and Supp. 1998). Alternatively, the phrase could mean that the FHLBanks may invest in “any [SBIC] . . . for the purpose of aiding members.” *Id.* Since the meaning of the limiting phrase is unclear and ambiguous, the Finance Board may look to the legislative history of the provision to determine its effect.

Congress added investments in SBICs to the list of authorized investments of FHLBank surplus funds in section 11(h) of the Bank Act as part of the Housing and Community Development Amendments of 1979 (HCD Amendments). See Pub. L. No. 96-153, tit. III, § 324,

¹ *Id.* §§ 684 and 685. Generally, a small business concern is an incorporated or unincorporated independently owned and operated entity that is not dominant in its field of operation. *Id.* §§ 662(5) and 632(a)(1). In order to be considered a small business concern, the entity must not exceed certain size standards established in regulations promulgated by the SBA. *Id.* § 632(a)(2); 13 C.F.R. part 121.

93 Stat. 1121 (Dec. 21, 1979). Subject to any regulations, restrictions, or limitations the Finance Board might prescribe, the HCD Amendments authorized a FHLBank to invest surplus funds in “stock, obligations, or other securities of any SBIC formed pursuant to section 301(d) of the Small Business Investment Act of 1958, for the purpose of aiding members of the [FHL]Bank System.” *Id.* Under section 301(d) of the Investment Act, the SBA licensed specialized SBICs, known as minority enterprise SBICs or MESBICs, to invest in small business concerns that were owned and operated by socially or economically disadvantaged persons.²

In a floor statement concerning the HCD Amendments, Senator Alan Cranston explained that if the FHLBanks had statutory authority to invest in SBICs, they would organize, invest \$5 million in, and operate a MESBIC the sole purpose of which would be to provide equity capital and technical assistance to troubled minority owned or managed savings and loan associations. See 125 CONG. REC. 18,539-542 (July 13, 1979). The results of a study conducted by the Finance Board’s predecessor agency, the Federal Home Loan Bank Board (FHLBB), indicated that almost half of the minority savings and loan associations then in existence were experiencing financial difficulties. *Id.* at 18,540. The MESBIC proposal was one of the methods suggested by FHLBB staff to improve the performance of the distressed minority owned or managed savings and loan associations. *Id.* There is no indication that the FHLBanks ever created the MESBIC discussed in the legislative history of the HCD Amendments or otherwise exercised the statutory authority to invest in SBICs. Neither the Financial Management Policy nor any other Finance Board policy specifically discusses the FHLBanks’ authority to invest in SBICs.

The purpose limitation in section 11(h) to investments in SBICs that aid FHLBank members made sense in light of the fact that at the time of the HCD Amendments, every savings and loan association was required to be a member of the FHLBank System.³ However, it is not clear either from the legislative history of the HCD Amendments or the plain language of section 11(h) of the Bank Act how this limitation was to be applied. Since Congress added this investment authority to allow the FHLBanks to organize, capitalize, and operate a MESBIC to assist member savings and loan associations, a strong argument can be made that the original purpose of the limitation was to authorize the FHLBanks to invest only in MESBICs that were “formed . . . for the purpose of aiding members.”

² See 15 U.S.C.A. § 681(d) (repealed & Rub. L. No. 104-208, div. D, tit. II, § 208(b)(3), 110 Stat. 3009-742 (Sept. 30, 1996)). In pertinent part, Investment Act section 301(d) authorized the SBA to license as a MESBIC an entity “the investment policy of which is that its investments will be made solely in small business concerns which will contribute to a well-balanced national economy by facilitating ownership in such concerns by persons whose participation in the free enterprise system is hampered because of social or economic disadvantages.” *Id.*

³ Federal savings and loan associations are required by statute to be FHLBank members. See 12 U.S.C.A. § 1464(f) (West 1989 and Supp. 1998). At the time of the HCD Amendments, in order to secure federal deposit insurance, state savings and loan associations were required to become FHLBank members. See, e.g., 58 Fed. Reg. 14513 (Mar. 18, 1993). The Office of Thrift Supervision replaced the deposit insurance condition with a regulatory requirement in 1993. See 12 C.F.R. § 563.49 (1995) (by its terms, the regulatory provision expired on April 19, 1995).

In 1996, Congress amended the FHLBanks' authority to invest in SBICs by replacing the reference to section 301(d) of the Investment Act, which was deleted, with a reference to section 301. See Small Business Programs Improvement Act of 1996 (Improvement Act), Pub. L. No. 104-208, div. D, tit. II, §§ 208(b)(3) and (h)(1), 110 Stat. 3009-742 and 747 (Sept. 30, 1996). Congress did not change the purpose limitation in section 11(h). As amended, section 11(h) of the Bank Act currently authorizes the FHLBanks to invest surplus funds, subject to Finance Board regulations, restrictions, and limitations, in stock, obligations, or other securities of any SBIC for the purpose of aiding FHLBank members. See 12 U.S.C.A. § 1431(h) (West 1989 and Supp. 1998).

According to the legislative history of the Improvement Act, Congress included the Bank Act amendment to enhance the FHLBanks' community and economic development mission by broadening the FHLBanks authority to invest in small businesses. See 142 CONG. REC. S11,898 (daily ed. Sept. 30, 1996) (statement of Sen. D'Amato). The legislative history states that the FHLBanks may invest in any SBIC "independently of whether the SBIC is owned by or affiliated with a banking organization" in order to "play a part in satisfying the needs of small businesses for venture capital." See *id.* S11,898-899 (citing Banking and Small Business Committees Joint Explanatory Statement). The legislative history then explains that the FHLBanks "would be furthering the legitimate objective of economic and community development through promoting small business investment and growth" by investing in SBICs only after the SBIC has raised "a significant amount of capital from private sources that demand a market-based financial return." See *id.*

The legislative history of the Improvement Act makes clear that the authority for a FHLBank to invest in an SBIC is broad. It also strongly suggests that the intent of the limiting phrase "for the purpose of aiding members of the [FHL]Bank System" in section 11(h) is to allow the FHLBanks to invest in any existing SBIC provided that the investment itself aids members.

Pursuant to its general authority to supervise the FHLBanks and its specific authority to regulate, restrict, or limit a FHLBank's investment in SBICs, the Finance Board has discretion to interpret the purpose limitation in section 11(h) of the Bank Act and apply its mandate in a way that is reasonable in light of Congress' intent. See 12 U.S.C.A. §§ 1422a(a)(3)(B)(i), 1422b(a)(1), and 1431(h) (West 1989 and Supp. 1998); *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 844 (1984). As long as the Finance Board's construction is reasonable, a court will accord it deference.⁴

Accordingly, the Finance Board has the authority to interpret the Bank Act to further the intent of Congress. Since the legislative history outlines inconsistent purposes for which the SBIC investment authority, including the limiting phrase "for the purpose of aiding members of the [FHL]Bank System," was passed, the Finance Board may construe the purpose limitation flexibly to further Congress' intent. See SUTHERLAND § 46.07 (a statute need not be construed

⁴ It is well settled that courts should give great weight to any reasonable interpretation of a statute by the agency charged with its enforcement, particularly when the agency has special expertise. See *Chevron; NationsBank of North Carolina, NA. v. Variable Annuity Life Ins. Co.*, 513 U.S. 251 (1995).

narrowly or literally if the construction would create a result. that would be contrary to legislative intent). However, because the Finance Board must give effect to each word that appears in the Bank Act, it is not free to interpret the purpose limitation out of section 11(h). See id. § 46.06. To give the limiting phrase “for the purpose of aiding members of the [FHL]Bank System” effect and yet interpret the SBIC investment provision of section 11(h) in a manner consistent with congressional intent, the Finance Board could permit the FHLBanks to form an SBIC that will aid members or make investments in any existing SBIC provided the investment itself somehow aids FHLBank members.

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