FHLBank at 100

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I appreciate this opportunity to comment on the special role the FHLBs play in the financial system. By way of background, I was in independent board member at the Seattle FHLB from 2014-2015, and then at the Des Moines FHLB from 2016-2017. I have PhD in economics and I was Chair of the Economics Department and Director of the Northwest Economic Research Center, both at Portland State University. I am currently Emeritus Professor of Economics.

In my money and banking course, the textbook would have a half page on the FHLBs and I accordingly spent they same time discussing it in class. Until I joined the board, I had little appreciation for the important role that the FHLBs play in the financial system. One just has to look at the Great Recession and the Pandemic to find how important the FHLBs were to providing critical liquidity to a segment of financial institutions. And after the Great Depression, the funding source for community banks truly assisted the US to be a nation of home owners.

Time marches on and the financial system is quite different than what it was from the 1930s to the 1980s. FHLBank at 100 is taking a holistic approach to assess the purpose and mission of the FHLBs. As stated above, the FHLBs have shown their importance in both the Great Recession and the Pandemic. Their soundness and safety has persevered and liquidity needs of institutions have allowed them to ride out some very difficult times. I think there is no question that the liquidity mission is still relevant.

As to the soundness and safety of the FHLBs, there are very stringent checks and balances. From my time on the audit committee at the Des Moines bank, I was very impressed with the open process and independence of the audit functions. I distinctly remember how we always reviewed the duration analysis (something SVB should have done). Risk management was carefully crafted and followed. Collateral for advances were fully investigated. No question in my mind that soundness and safety were always at the forefront.

Besides liquidity needs, the mission of the FHLBs consisted of promoting housing and community development. There is no question in my mind that small community banks were able to get advances that were competitive with larger banks. I liken it to the ACE Hardware model. How does ACE Hardware compete with Loews and Home Depot? At the top, they buy for all the stores, passing on the savings from large lot buys. This enables small community banks to provide mortgages, business loans, and other community develop needs.

While we can be relatively assured that smally community banks assist their local areas, there is a question about large members (e.g., Well Fargo) and how they use advances. It could very well be that large members are meeting their regulatory asset needs thru FHLB advances, basically not directly assisting local communities. From my time on the board, it never appeared that the large members advances decreased access to advances from small members – or there was no “crowding-out”. In that sense, the large member advances provided income that assisted soundness and safety at the FHLB and contributed to increasing the AHP. But if the large members are only using the advances for meeting regulatory requirements, then the housing and community development are further removed. I would suggest that there could be a threshold for which tracing of the use of advances would apply. Basically, “large” members would have to report where the advances are going while “small” members would not be subject to reporting. Tracking is costly and we can be more assured that “small” members are working with their community, and ‘”large” members tend to have the overhead that can handle the additional costs of tracking.

There are many other issues that are being addressed in the FHLBank at 100. I’ve only addressed a few. From my experience, the FHLBs is as relevant today as it was in the 1930s. I applaud the firming up of the mission and look forward to the FHLBs continuing on stabilizing the financial system and assisting communities through their members.