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Statement of the Shadow Financial Regulatory Committee

On

Federal Home Loan Banks

Although most of the commentary about the recently enacted Gramm-Leach-Bliley Act has focused on its elimination of some competitive barriers in the financial services field, in the long run the new powers granted to the Federal Home Loan Banks (FHLBs) may be among the most significant elements of the legislation.

The FHLBs are government sponsored enterprises (GSEs) that were originally created for the purpose of subsidizing and providing liquidity assistance to the S&L industry, which was in turn to provide financing for housing. Because they are perceived to have the implicit backing of the United States government, the FHLBs can borrow in the financial markets at highly favorable rates, and their loans to S&Ls were part of the government's long-standing policy to encourage greater home ownership.

With the maturity of the housing finance system in the United States, it has become clear that this form of government support for residential finance is not necessary. Under these circumstances, the FHLBs should have been abolished, but Congress has been unwilling or unable to do so. Instead, over the last few years, the FHLBs have been allowed to extend their lending activities to commercial banks that were heavily engaged in housing finance.

In the Gramm-Leach-Bliley Act, Congress has taken a major step to further expand the scope of the FHLBs' activities—authorizing them for the first time to make loans to "community financial institutions" (defined in the Act as banks and credit unions with assets of $500 million or less) that are collateralized by loans to small business and agriculture. Previously, FHLB loans could only be collateralized by housing loans.

restrict the growth of Fannie Mae and Freddie Mac—will be met with protests from small banks as well as the affected groups.

The Committee urges Congress to revisit this issue promptly and repeal the provisions of the Gramm-Leach-Bliley Act before it loses the ability to control the FHLBs. In the process, Congress should check the growth of all the GSEs, given the implications of this growth for competitive private financial markets.