



# Federal Home Loan Bank of Pittsburgh

April 11, 2002

Elaine L. Baker  
Secretary to the Board  
Federal Housing Finance Board  
1777 F Street, N.W.  
Washington, D.C. 20006

## **RE: Comments for the Public Record Regarding Mandated Activity-Based Stock Purchase Requirements**

Dear Ms. Baker:

Thank you for the opportunity to comment on this important issue. For the reasons set forth below, we believe that a stock purchase requirement in support of Acquired Member Assets ("AMA") is neither mandated by law nor good public policy.

### **I. LAW**

The Federal Home Loan Bank Act ("Bank Act") does not mandate or suggest that capital plans of the Home Loan Banks require members to purchase capital stock as a condition of conducting each activity with the Banks. In fact, the Bank Act expressly provides that the Banks may be fully capitalized with a membership-based stock purchase requirement only. Activity-based stock purchase requirements are to be optional at the discretion of the board of directors of a Home Loan Bank.

Congress vested this discretion in the local boards of directors as part of the directors' duty to determine what is in the best interest of the members of their Bank. The following provisions of the Bank Act unquestionably establish this point:

- Section 6(a)(4)(A):

"The regulations issued by the Finance Board under paragraph (1) shall:  
(A) permit each Federal Home Loan Bank to issue, with such rights, terms and preferences, not inconsistent with this Act and the regulations issued thereunder, as the board of directors of that bank may approve..."

[emphasis added]

- Section 6(b)(1)(A):

“Not later than 270 days after the date of publication by the Finance Board of final regulations in accordance with subsection (a), the board of directors of each Federal Home Loan Bank shall submit for Finance Board approval a plan establishing and implementing a capital structure for such Bank that –

**(A) the board of directors determines is best suited for the condition and operation of the bank and the interests of the members of the bank;”**  
[emphasis added]

- Section 6(c)(1):

“(A): In general. Each capital structure plan of a Federal home loan bank shall require each member of the bank to maintain a minimum investment in the stock of the bank, **the amount of which shall be determined in a manner to be prescribed by the board of directors of each bank and to be included as part of the plan.** [emphasis added]

B): Investment alternatives.

(i) In general. In establishing the minimum investment required for each member under subparagraph (A), **a Federal home loan bank may, in its discretion,** include any 1 or more of the requirements referred to in clause (ii), or any other provisions approved by the Finance Board.” [emphasis added]

The Bank Act clearly vests in the board of directors of each Home Loan Bank the authority to decide whether to require an activity-based stock purchase requirement, and if so, which activity will be subject to such a requirement. This discretion was provided for a very good reason. The board of directors has to consider many factors when making decisions that affect the allocation of the benefits and obligations of membership among the members. These decisions are intertwined. The imposition of a capital stock purchase requirement is just one of the many decisions that affect the allocation of benefits within the cooperative.

For example, a decision to lower the price charged for advances will result in a lower total return price for selling AMA assets to the Bank. This is because the price charged on advances directly affects the dividend rate, and because the rate paid on stock purchased to support AMA activity will be part of the total return for selling assets to the Bank, the decision on advance rates would directly affect MPF® pricing. A mandated stock purchase requirement for AMA undermines a board’s ability to develop a comprehensive plan for allocating the benefits and obligations of membership.

In summary, there is nothing in the law that requires a stock purchase requirement for AMA assets. The law provides for local boards of directors to decide whether they want to establish a stock purchase requirement for AMA activities (subject to Finance Board approval).

## **II. PUBLIC POLICY**

Having established that mandated stock purchase requirements for AMA are indeed inconsistent with the law, we turn now to the public policy implications of such requirements.

As Chairman Korsmo well emphasized recently, the Finance Board is, first and foremost, a safety and soundness regulator. To mandate a stock purchase requirement for AMA activities, in the absence of a valid safety and soundness concern or legal requirement, seems to position the Finance Board in a governance role rather than that of regulator.

The absence of an AMA capital stock purchase requirement in the Pittsburgh Bank's capital plan in no way creates an unsafe or unsound condition. First, the Bank has clearly demonstrated through extensive pro forma scenario testing as part of its capital plan submission that it remains appropriately capitalized under a broad range of business and economic conditions.

Secondly, from a "commonality" standpoint, the absence of AMA capital stock purchase requirements from one or more Home Loan Banks does not create an unsafe and unsound condition at either the Bank or System level. Notwithstanding that there has been a single statutory stock purchase requirement for over 70 years, there are significant differences in the terms and conditions of capital stock among the Home Loan Banks. For example, some Home Loan Banks pay stock dividends while others pay cash dividends; some Home Loan Banks redeem excess stock routinely while others elect not to; and the allocation of the financial benefits of membership between product pricing and dividend returns vary broadly from Home Loan Bank to Home Loan Bank. History clearly demonstrates that commonality of terms and conditions of capital stock is not a requirement of a safe, sound and vibrant Home Loan Bank System.

Some have suggested that the prospect of multi-bank membership or competition among the Home Loan Banks could raise the commonality issue to the level of a safety and soundness concern. This suggestion seems to ignore the fact that there are over one hundred institutions that indirectly own capital stock in more than one Bank. The Home Loan Banks to some considerable extent already compete under today's varying terms and conditions of capital stock. This competition has not caused any dislocation that has resulted in an unsafe and unsound condition at a Home Loan Bank. Moreover, the statute establishes a floor for the level of capital (below which the Banks may not operate) that well exceeds prudent capitalization levels.

Third, from a "maintaining the cooperative" standpoint, the absence of a stock purchase requirement on AMA will not result in an unsafe and unsound condition. The capital stock purchase requirements that are currently contained in the Pittsburgh Bank plan are fully consistent with the principle of maintaining the cooperative nature of the Bank. Membership is voluntary. The same capital rules apply to each member. Each member can choose which activities it wishes to conduct with the Bank. The members elect representation to the Bank's board of directors from among their peers. The board of directors, in turn, decides the terms and conditions of the capital structure that best meets the needs of the members.

Nothing herein even suggests that a safety and soundness issue will be raised by not requiring members that sell AMA to the Bank to purchase capital stock. We would observe that the lack of a stock purchase requirement on AMA to date has not resulted in an unsafe or unsound condition at the Bank. Incidentally, some Home Loan Banks impose an AMA stock requirement today and some do not.

### **III. PRODUCT AND OPERATIONAL ISSUES**

Certainly the primary thrust of the Finance Board's review and analysis of each capital plan must be that of safety and soundness. However, another reason to refrain from imposing ongoing stock purchase requirements on AMAs is that doing so would, in our view, likely render programs like MPF® and MPP uncompetitive. In the end, most of our members would find the imposition of ongoing stock requirements against loans sold to or originated by their Home Loan Bank long ago (10, 15, 20+ years?) to be so disconnected from the way the housing finance markets operate as to be a "non-starter" from the standpoint of product design. We cannot imagine how Fannie Mae or Freddie Mac could "attach strings" to customers for loans they sold them as long as 30 years ago and maintain an effective program.

At the risk of further complicating the issue, consider the realities of intra-System participations of MPF® and MPP loan balances. To illustrate the point, the Pittsburgh Bank has participated a significant portion of its MPF® production volume to the Chicago Bank. Will the Pittsburgh members be required to maintain capital stock in the Pittsburgh Bank in order to support Chicago Bank assets? Alternatively, might Pittsburgh members be required to purchase Chicago Bank stock to support what are now Chicago's assets? Would Chicago members be required to capitalize assets acquired from Pittsburgh? Would additional intra-System participation and pooling activity present member institutions with an ever-expanding mix of stock purchase requirements involving a growing roster of Home Loan Banks and related stock instruments following each down-stream purchase and sale of loans – i.e., loans that members never owned in the first place? Hopefully, this illustrates the flaw that begins with a faulty premise: i.e., that the law or public policy necessarily requires members to capitalize assets sold to or originated by the Home Loan Banks.

### **IV. CAPITAL SUFFICIENCY TEST**

We believe it is inappropriate for the Finance Board to require the Banks to include in their capital plans yet another formula for determining whether they are in compliance with the capital regulation. The regulation is clear enough as to what minimum levels of capital are required, both for the leverage requirement as well as for the risk-based requirement. No additional formulae are necessary. In the case of the Pittsburgh Bank, the capital sufficiency test is irrelevant. Our plan exceeds the limits in all cases. What is the purpose of a regulatory requirement that has no impact?

Were the Finance Board to determine that additional regulations are necessary to guide the Banks in regard to safety and soundness, the capital plans should not serve as the vehicle for such rule making. The capital plans are documents that govern the relationships between the Banks and their members, not the relationship between the Banks and the Finance Board. There are more appropriate tools available to the Finance Board to issue supervisory guidance to the Banks.

Elaine L. Baker  
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Thank you again for the opportunity to comment on this very important issue. Please contact either Dana A. Yealy, Senior Vice President and General Counsel, at (412) 288-2833 or Eric J. Marx, Senior Vice President and Chief Financial Officer, at (412) 288-3431 if you have any questions.

Sincerely,