



April 2015

# FEDERAL HOME LOAN BANKS

Collateral  
Requirements  
Discourage Some  
Community  
Development  
Financial Institutions  
from Seeking  
Membership

Accessible Version

# GAO Highlights

Highlights of [GAO-15-352](#), a report to congressional requesters

## Why GAO Did This Study

The Housing and Economic Recovery Act of 2008 (HERA) made nondepository CDFIs eligible for membership in the FHLBank System. The System includes 12 regional FHLBanks that make loans, known as advances, to their members at favorable rates. GAO was asked to review the FHLBanks' implementation of HERA provisions relating to nondepository CDFIs. Among other things, this report discusses (1) challenges posed by membership and collateral requirements for nondepository CDFIs, and (2) FHFA and FHLBank efforts to facilitate broader nondepository CDFI participation in the System.

GAO analyzed data on membership rates as of December 2014 and advances obtained as of September 2014; reviewed requirements for gaining membership and obtaining advances; and interviewed FHLBank and FHFA officials and a sample of nondepository CDFIs based on selected criteria, including geography and asset size. Specifically, GAO interviewed 10 nondepository CDFIs that were members (one from each FHLBank district with a nondepository CDFI member when GAO began work) and 12 that were not members (one from each of the 12 districts).

GAO makes no recommendations in this report. GAO provided a draft of this report to FHFA and the 12 FHLBanks for comment. FHFA and four FHLBanks provided technical comments that were incorporated into the report as appropriate.

View [GAO-15-352](#). For more information, contact Daniel Garcia-Diaz at (202) 512-8678 or [GarciaDiazD@gao.gov](mailto:GarciaDiazD@gao.gov).

April 2015

## FEDERAL HOME LOAN BANKS

### Collateral Requirements Discourage Some Community Development Financial Institutions from Seeking Membership

## What GAO Found

Collateral requirements rather than membership requirements discouraged some nondepository community development financial institutions (CDFI)—loan or venture capital funds—from seeking membership in the Federal Home Loan Bank (FHLBank) System. CDFIs are financial institutions that provide credit and financial services to underserved communities. Less than 6 percent of nondepository CDFIs (30 of 522) were members of the System as of December 2014 (see figure). Requirements for membership (such as stock purchase amounts) can vary where regulation gives FHLBanks discretion, but nondepository CDFIs GAO interviewed generally stated these requirements did not present a challenge. In addition, most FHLBanks imposed collateral requirements on nondepository CDFIs—such as haircuts (discounts on the value of collateral)—comparable with those for depository members categorized as higher risk. (This was sometimes also the case for other nondepository members such as insurance companies.) FHLBank officials stated nondepository CDFIs have different risks compared with depository members (for example, nondepository CDFIs are not supervised by a prudential federal or state regulator as are other FHLBank members). To address these risks, they imposed more restrictive requirements. Some of the nondepository CDFIs GAO interviewed cited limited availability of eligible collateral and steep haircuts as challenges for obtaining advances and therefore a disincentive to seeking membership. Less than half of the nondepository CDFIs that were members as of September 2014 had borrowed from the FHLBanks; the cumulative advances from October 2010 to September 2014 totaled about \$307 million (less than 1 percent of the total advances outstanding as of December 2014). Two FHLBanks made the majority of the advances.

Rates of Nondepository CDFI Membership by FHLBank District, as of December 2014

District	Cumulative number of nondepository CDFI members					Total CDFIs in district	Membership rate
	2010	2011	2012	2013	2014		
Atlanta	1	1	1	1	2	73	2.74%
Boston	0	0	0	1	4	48	8.33
Chicago	0	1	1	1	1	24	4.17
Cincinnati	1	3	4	4	4	30	13.33
Dallas	0	0	2	3	4	45	8.89
Des Moines	0	1	1	1	1	48	2.08
Indianapolis	0	0	0	1	2	13	15.38
New York	0	0	1	2	2	63	3.17
Pittsburgh	0	0	0	0	1	32	3.13
San Francisco	0	2	3	4	5	68	7.35
Seattle	0	0	0	0	2	53	3.77
Topeka	0	0	0	0	2	25	8.00
<b>Total</b>	<b>2</b>	<b>8</b>	<b>13</b>	<b>18</b>	<b>30</b>	<b>30 + 492 nonmembers = 522</b>	<b>5.75%</b>

Legend: Members (solid blue), Nonmembers (hatched blue). CDFI = community development financial institution

Source: GAO analysis of FHFA membership database and CDFI Fund data. | GAO-15-352

The Federal Housing Finance Agency (FHFA), which oversees the System, and FHLBanks have facilitated efforts to broaden nondepository CDFI participation in the System by educating about and promoting membership to nondepository CDFIs. For example, FHFA officials told us that they encouraged the FHLBanks to hold a conference to discuss nondepository CDFI membership. Officials from 10 FHLBanks also stated that they had solicited applications from CDFIs. In late 2014, several FHLBanks amended stock purchase and collateral requirements to better accommodate nondepository CDFI membership and access to advances.

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**Abbreviations**

CARS	CDFI Assessment and Ratings System
CDFI	community development financial institution
CDFI Fund	Community Development Financial Institutions Fund
FDIC	Federal Deposit Insurance Corporation
FHFA	Federal Housing Finance Agency
FHLBank	Federal Home Loan Bank
FHLBank System	Federal Home Loan Bank System
GAAP	generally accepted accounting principles
HERA	Housing and Economic Recovery Act of 2008
NCUA	National Credit Union Administration
OFN	Opportunity Finance Network
Treasury	Department of the Treasury

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April 23, 2015

The Honorable Maxine Waters  
Ranking Member  
Committee on Financial Services  
House of Representatives

The Honorable Carolyn Maloney  
Ranking Member  
Subcommittee on Capital Markets and  
Government-Sponsored Enterprises  
Committee on Financial Services  
House of Representatives

The Honorable Keith Ellison  
House of Representatives

The Federal Home Loan Bank System (FHLBank System), which is a government-sponsored enterprise created to support mortgage lending and related community development, includes 12 regional Federal Home Loan Banks (FHLBank) with over 7,300 financial institutions that are active members. The primary mission of the FHLBank System is to serve as a reliable source of liquidity for its members. To carry out its mission, the FHLBank System issues debt in capital markets, generally at relatively favorable rates due to its status as a government-sponsored enterprise, and each FHLBank makes loans known as advances to its member financial institutions. As of December 31, 2014, the FHLBanks had about \$566 billion in total outstanding advances. FHLBank members must pledge collateral to secure these advances.

FHLBank members include banks, thrifts, credit unions, and insurance companies—as well as community development financial institutions (CDFI) certified by the Community Development Financial Institutions Fund (CDFI Fund) within the Department of the Treasury (Treasury).<sup>1</sup> CDFIs can be federally insured depository institutions such as community development banks and certain credit unions or nondepository institutions

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<sup>1</sup>The CDFI Fund was established by the Riegle Community Development and Regulatory Improvement Act of 1994, Pub. L. No. 103-325, § 104, 108 Stat. 2160, 2166 (1994).

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such as community development loan funds or venture capital funds. Depository CDFIs have been eligible to apply for FHLBank membership since 1989 and nondepository CDFIs since 2010, when the Federal Housing Finance Agency (FHFA) implemented provisions of the Housing and Economic Recovery Act of 2008 (HERA) that authorized such membership.<sup>2</sup> FHFA is the supervisor and regulator of the FHLBank System and aims to promote the safe and sound operation of FHLBanks and the achievement of their mission.

You asked us to examine the FHLBanks' implementation of HERA provisions relating to nondepository CDFIs. This report discusses (1) how nondepository CDFIs differ from other members of the FHLBank System, in particular depository members; (2) the membership and collateral requirements for nondepository CDFIs and challenges posed by these requirements; and (3) FHFA oversight of FHLBanks in relation to nondepository CDFIs and efforts by FHFA and FHLBanks to increase participation of nondepository CDFIs in the FHLBank System.

To describe differences between nondepository CDFIs and other members of the FHLBank System, we reviewed relevant sections of HERA, FHFA's final rule on nondepository CDFI membership, and other relevant information from the FHLBanks and CDFI industry. We analyzed data on members' asset size from FHFA's membership database as of December 31, 2014. To address membership and collateral requirements, we reviewed relevant legislation and regulations, and documentation (such as membership applications and FHLBank guidance on assessing nondepository CDFIs for membership) to determine membership requirements and identify any differences among FHLBank policies.<sup>3</sup> We analyzed data on the number of nondepository CDFIs that were members in calendar years 2010 through 2014 from FHFA's membership database as of December 31, 2014. We calculated the

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<sup>2</sup>See Pub. L. No. 110-289, § 1206, 122 Stat. 2654, 2787 (2008) (codified at 12 U.S.C. § 1424(a)); 12 C.F.R. Parts 1263, 1290. In addition to community development loan funds and venture capital funds, HERA made state-chartered credit unions without federal insurance eligible for FHLBank membership. They must meet stricter financial standards than federally insured depository institutions. See 12 CFR § 1263.11(b)(3)(iii).

<sup>3</sup>Nondepository CDFIs are subject to specific financial condition requirements. We requested and received financial data from the CDFI Fund but determined that the dataset did not contain relevant data needed to determine how many nondepository CDFIs could meet these financial condition requirements.

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membership rate (the percentage of nondepository CDFIs in each district that were members) by using data from FHFA's membership database and Treasury's CDFI Fund. In addition, we reviewed relevant documentation such as FHLBank collateral guidelines and product and credit policies to determine the FHLBanks' requirements for obtaining advances. While we were able to review each FHLBank's collateral policies and procedures, the confidentiality of such proprietary information limited what we could publicly disclose in our report.<sup>4</sup> We also obtained data from each FHLBank on the amount of advances nondepository CDFI members obtained from October 2010 through September 2014 (the most recent data available at the time of our request). We reviewed documentation on and interviewed knowledgeable officials about the data we used and determined they were sufficiently reliable for assessing members' asset size (data from FHFA's membership database), the membership rates for nondepository CDFIs (data from FHFA's membership database and the CDFI Fund), and the amount of advances each nondepository CDFI member obtained (data from individual FHLBanks).

We interviewed officials from the 12 FHLBanks, 3 trade groups, 10 nondepository CDFIs that were members of the FHLBanks, and 12 nondepository CDFIs that were not members to help understand the level of demand for FHLBank membership and obtain views on any challenges associated with obtaining membership and advances. We selected the two purposive, nonrandom samples of nondepository CDFIs (10 members and 12 nonmembers) using data from FHFA's membership database. We sought variation in factors such as geographic location and asset size. The results of our interviews with the 22 nondepository CDFIs cannot be generalized to all nondepository CDFIs.

To evaluate FHFA's oversight, we reviewed relevant laws, legislative history, and regulations in relation to authority to expand membership to nondepository CDFIs and FHFA's oversight authority. We also reviewed FHFA's examination policies for membership and collateral requirements to obtain advances. To determine what, if any, findings concerned membership and advance practices, we analyzed each FHLBank's

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<sup>4</sup>Specifically, because the collateral haircut (discount) policies of the FHLBanks generally are considered proprietary information, we were unable to attribute specific policies to individual FHLBanks. Where appropriate, we used randomly assigned numbers when discussing FHLBank collateral policies to prevent disclosure of FHLBank identities.



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examination results for fiscal years 2010 through 2013 (the most recent available at the time of our request). We interviewed FHFA and the 12 FHLBanks to further understand examination policies and practices for membership and advances and discuss any efforts to facilitate broader nondepository CDFI participation in the FHLBank System. See appendix I for a more detailed description of our methodology.

We conducted this performance audit from May 2014 to April 2015 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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## Background

The CDFI Fund provides certification to CDFIs that meet the six statutory and regulatory criteria of the Fund.<sup>5</sup> CDFI Fund certification is conferred on CDFIs that have the primary mission of providing capital and development services to economically distressed communities generally underserved by conventional financial institutions. CDFIs provide products and services (such as mortgage financing for low-income and first-time homebuyers and financing for not-for-profit affordable housing developers) that otherwise may not be accessible in these communities. CDFIs can be for-profit or nonprofit institutions and can be funded by private and public sources. Depository CDFIs such as community development banks and credit unions obtain capital from customers and nonmember depositors. Depository and nondepository CDFIs may obtain funding from conventional financial institutions, such as banks, in the form of loans. In addition, both types of CDFIs may receive funding from corporations, individuals, religious institutions, and private foundations. Finally, CDFIs may apply for federal grants and participate in federal loan programs. For example, Treasury's CDFI Fund makes grants, equity investments, loans, and deposits to help CDFIs serve low-income people

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<sup>5</sup>The CDFI Fund confers certification to a legal entity that meets six statutory and regulatory criteria: the CDFI must have a primary mission of promoting community development; serve principally an investment area or targeted population; be an insured depository institution, or make loans or development investments as its predominant business activity; provide development services (such as technical assistance or counseling) in conjunction with its financing activity; maintain accountability to its target market; and be a nongovernmental entity.

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and communities.<sup>6</sup> Other federal funding sources include loan programs administered by the Department of Agriculture and the Small Business Administration. As of December 31, 2014, there were a total of 933 certified CDFIs (411 depository and 522 nondepository).

The 12 FHLBanks are regionally based cooperative institutions owned by member financial institutions (see fig. 1).<sup>7</sup> To become a member of its regional FHLBank, a financial institution (such as a nondepository CDFI) must meet certain eligibility requirements and purchase capital stock; thereafter, it must maintain an investment in the capital stock of the FHLBank sufficient to satisfy the minimum investment required for that institution in accordance with the FHLBank's capital plan.<sup>8</sup>

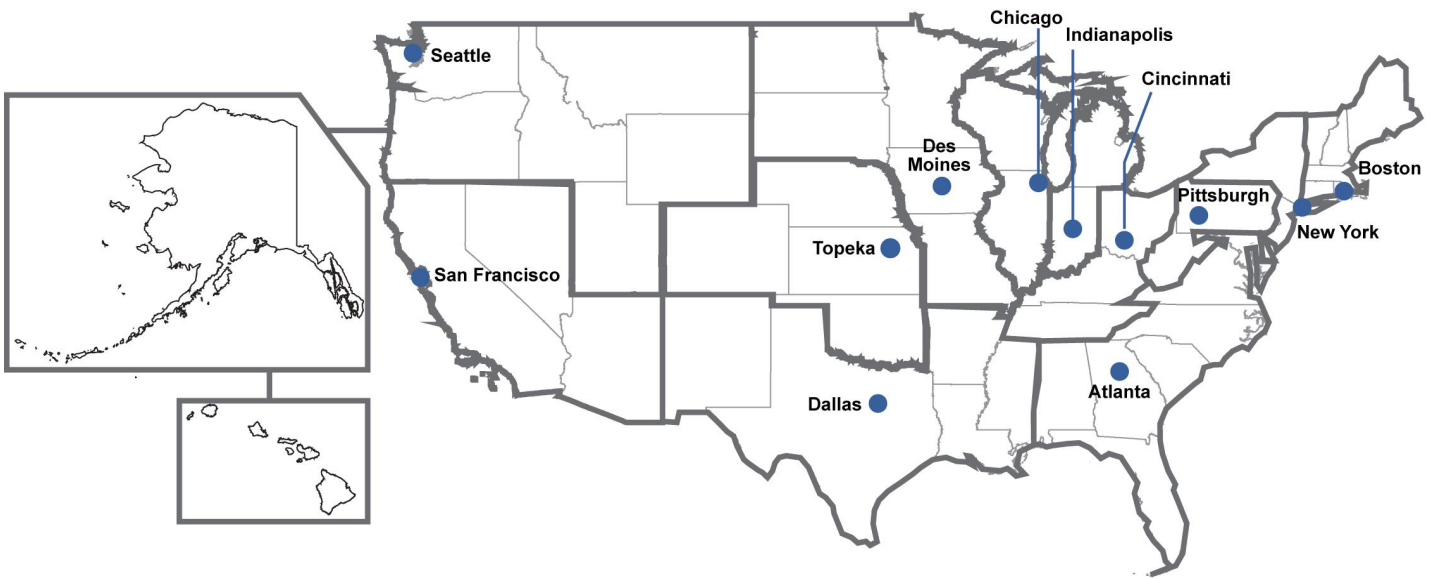
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<sup>6</sup>The CDFI Fund administers a number of programs that make awards to CDFIs annually through competitive application processes. Its programs include those that provide financial assistance awards, technical assistance grants, bond guarantees, and tax credit allocation authority.

<sup>7</sup>On February 27, 2015, the FHLBank of Des Moines and the FHLBank of Seattle announced that the members of both FHLBanks had ratified an agreement approved by their boards of directors in September 2014 to merge. The FHLBanks anticipate that the merger will be effective by the middle of 2015.

<sup>8</sup>12 C.F.R. § 931.3(d).

**Figure 1: The 12 Federal Home Loan Banks and Districts**



Source: Federal Home Loan Banks (data); MapInfo (map). | GAO-15-352

The FHLBanks extend advances almost exclusively to their members,<sup>9</sup> which in turn can use the advances to fund lending such as mortgages.<sup>9</sup> Advances are the largest category of assets of the FHLBanks on a combined basis, representing about 62 percent of all assets as of September 30, 2014. Other benefits of FHLBank membership for financial institutions include earning dividends on their capital investments and access to various products and services, such as letters of credit and payment services. The FHLBanks also offer affordable housing and community and economic development lending through the Affordable Housing Program and the Community Investment Program. Under these programs, the FHLBanks provide grants and advances to their members, and the members use these funds to benefit certain households or

<sup>9</sup>Although they are not FHLBank members, the FHLBanks also make advances to eligible housing associates (primarily state housing finance agencies). The eligibility requirements and application process for organizations seeking to be certified by FHLBanks as housing associates are set forth in 12 CFR Part 1264. Housing associates represented approximately 0.06 percent of the par value of advances outstanding as of December 31, 2014.

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communities.<sup>10</sup> Some of the FHLBanks have their own programs designed to support community development. For instance, FHLBank-Chicago developed its Community First Fund in 2013 as a \$50 million revolving loan fund that supports member and nonmember community development institutions, including CDFIs.

The FHLBanks protect against credit risk on advances by requiring borrowers to pledge collateral. As established by statute and FHFA regulations, the FHLBanks must develop and implement collateral standards and other policies to mitigate the risk of default on outstanding advances. Collateral arrangements vary with borrower credit quality, borrowing capacity, and collateral availability, as well as the FHLBank's overall credit exposure to the borrower. Each FHLBank establishes borrowing capacity by determining the amount it will lend against each collateral type. An FHLBank can require additional or substitute collateral during the life of an advance to protect its security interest. For example, additional collateral is required when a member does not have sufficient collateral pledged to support outstanding credit exposure. Substitution generally occurs if the borrower's previously pledged collateral becomes ineligible. An FHLBank also may establish separate or additional collateral requirements for different member types (such as insurance companies) perceived to have different types of risks than federally insured depository institutions.

Based on the borrower's financial condition, the collateral pledge method generally falls into one of three categories: blanket lien, listing, and delivery.

- Blanket lien is the least restrictive collateral status and generally is assigned to lower-risk institutions. A blanket-lien agreement secures

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<sup>10</sup>Each FHLBank must contribute annually to its Affordable Housing Program the greater of (1) 10 percent of the FHLBank's net earnings for the previous year or (2) the FHLBank's pro rata share of an aggregate of \$100 million to be contributed in total by the FHLBanks. 12 U.S.C. §1430(j)(5)(C); 12 C.F.R. §1291.2(a). Recipients are to use Affordable Housing Program funds to benefit very-low income and low- or moderate-income households. Very low-income households are defined as households with incomes of 80 percent or less of area median income. Very low-income households are defined as households with incomes of 50 percent or less of area median income. 12 C.F.R. § 1291.3. Under the Community Investment Program, housing advances must benefit households at or below 115 percent of area median income, while economic development advances must benefit either low- or moderate-income households or economic development projects located in low- or moderate-income neighborhoods. 12 U.S.C. § 1430(i)(2).

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the right of the FHLBank to specified member assets, which may be all of the member's assets in the event the member fails or defaults on outstanding advances, usually on a first lien status. Generally, the FHLBank has priority over all other creditors, including the Federal Deposit Insurance Corporation (FDIC).<sup>11</sup> Most FHLBanks rely on a blanket lien agreement to secure advances without taking possession of the collateral, and the borrower may retain possession of documentation on eligible collateral pledged to the FHLBank.

- Under listing status, the borrower may retain possession of documentation on specific collateral pledged, but must provide a list of loans pledged with detailed loan information.
- Under delivery status, the borrower delivers pledged collateral to the FHLBank or a third-party custodian approved by the FHLBank.<sup>12</sup> This typically puts the security interest of the FHLBank in the most senior position over other creditors.

FHLBanks also seek to manage risk and mitigate potential losses by applying varying haircuts, or discounts, to collateral pledged to secure advances. For example, an FHLBank member might seek to pledge a portfolio of single-family residential mortgage loans with a value of \$100 million to secure an advance from its district FHLBank.<sup>13</sup> If the FHLBank applied a haircut of 25 percent to such collateral, the member generally would be able to secure advances of up to \$75 million, subject to other

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<sup>11</sup>In a typical bank or thrift failure, FDIC, acting as receiver, is responsible for all advances and other credit obligations of the failed institution. Generally, FDIC will facilitate a purchase and assumption transaction with another financial institution, which then will become responsible for the FHLBank advances. If another financial institution were not found to assume the failed institution's obligations, FDIC would be responsible for the payment of the FHLBank advances by selling the failed institution's assets, including collateral that had been pledged to secure the advances, to mitigate losses to the Deposit Insurance Fund. However, such a sale could not occur until FDIC had fully satisfied or repaid the outstanding credit obligations of the failed institution. An acquiring bank also may purchase and assume the assets and liabilities of the failed member, including collateral that had been pledged to secure advances.

<sup>12</sup>The method of delivery depends on the type of collateral being pledged. Tangible collateral, such as certified securities or mortgage promissory notes, is delivered by physically transferring these documents to the FHLBank or its custodian. Intangible collateral, such as securities that exist only in electronic form, is delivered by crediting them to the account of the FHLBank or its custodian.

<sup>13</sup>Single-family mortgage loans are loans for 1–4 unit properties.

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risk-management policies of the FHLBank.<sup>14</sup> The FHLBanks may apply haircuts based on factors such as risks associated with the member's creditworthiness, the type of collateral being pledged, and illiquidity of the collateral.

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## Nondepository CDFIs Differ from Other FHLBank Members in Several Ways

The differences among nondepository CDFIs and other FHLBank members range from the degree to which they focus on community development to differences in size and supervision. Two member types—nondepository and depository CDFIs—share a primary community development focus. As noted previously, both types of CDFIs must have a primary mission of promoting community development to be certified by the CDFI Fund. CDFIs serve as intermediary financial institutions that promote economic growth and stability in low- and moderate-income communities. Frequently, CDFIs serve communities that are underserved by conventional financial institutions and may offer products and services that generally are not available from conventional financial institutions. Such products and services include mortgage financing for low-income and first-time homebuyers; homeowner or homebuyer counseling; financing for not-for-profit affordable housing developers; flexible underwriting and risk capital for needed community facilities; financial literacy training; technical assistance; and commercial loans and investments to assist start-up businesses in low-income areas. Although other FHLBank members may provide similar services to similar populations, community development may not be their primary mission.

Nondepository CDFIs are smaller in asset size than most depository institution and insurance company FHLBank members. As of December 31, 2014, active members of the FHLBank System had approximately \$20 trillion in assets. As shown in table 1, as of the same date, median assets for nondepository CDFI members (approximately \$43 million) were lower than median assets for both depository members (approximately \$207 million) and insurance company members (approximately \$975 million). The largest nondepository CDFI had about \$708 million in assets, while the largest insurance company member had assets of about \$393 billion and the largest depository member had assets of about \$2 trillion. In addition, the 30 nondepository CDFI members altogether

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<sup>14</sup>For example, FHLBanks may set limits on the total amount of outstanding advances to an individual member. These limits are independent of the level of eligible collateral that a member must pledge to secure its advances.

accounted for about .01 percent of the total assets of all active FHLBank members, whereas depository and insurance company members held about 77 percent and about 23 percent of FHLBanks assets, respectively.

**Table 1: Distribution of Total Assets for FHLBank Members by Type, as of December 31, 2014 (Dollars in Millions)**

	Number of active members	Minimum assets	25th percentile	Median	75th percentile	Maximum assets
Nondepository community development financial institutions <sup>a</sup>	30	\$0.90	\$20.65	\$42.57	\$83.20	\$707.86
Depository institutions <sup>b</sup>	7,025	3.15	102.71	207.28	477.27	2,008,808.00
Insurance companies <sup>c</sup>	302	0.70	217.29	974.58	5,590.22	392,833.72

Source: GAO analysis of FHFA data. | GAO-15-352

<sup>a</sup>Assets for one nondepository CDFI are as of December 31, 2013, assets for another nondepository CDFI are as of March 31, 2014, and assets for a third nondepository CDFI are as of June 30, 2014. Assets for all other nondepository CDFIs are as of December 31, 2014.

<sup>b</sup>Depository institution members include commercial banks, credit unions, depository CDFIs, savings associations, and savings banks. Assets for one credit union and one commercial bank were not available. Assets for all other depository institutions are as of December 31, 2014.

<sup>c</sup>Assets for two insurance companies were not available. Assets for all other insurance companies are as of December 31, 2014.

In addition, nondepository CDFIs are not supervised by a prudential federal or state regulator unlike other FHLBank members. Depository FHLBank members are regulated and supervised by federal and state agencies that have responsibility for helping ensure the safety and soundness of the financial institutions they oversee, promoting stability in the financial markets, and enforcing compliance with applicable consumer protection laws.<sup>15</sup> To achieve these goals, regulators establish capital requirements for banks and conduct on-site examinations and off-site monitoring that assesses their financial condition, including assessing their compliance with applicable laws, regulations, and agency guidance. The insured depository institutions also must submit to their regulators quarterly financial information commonly known as Call Reports that

<sup>15</sup>See 12 U.S.C. § 1831o. The Board of Governors of the Federal Reserve System oversees state-chartered banks and trust companies that belong to the Federal Reserve System; FDIC regulates state-chartered banks that do not belong to the Federal Reserve System as well as federally insured state savings banks and thrifts; the National Credit Union Administration (NCUA) supervises federally chartered or insured credit unions; and the Office of the Comptroller of the Currency supervises national banks and federal savings associations. The Bureau of Consumer Financial Protection supervises the consumer businesses of banks with over \$10 billion in assets.

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follow generally accepted accounting principles (GAAP).<sup>16</sup> Insurance companies are regulated primarily by state insurance commissioners and are subject to examination.<sup>17</sup> While the CDFI Fund's review standards are not equivalent to the examination standards applicable to regulated depository institutions, the Fund requires a nondepository CDFI to submit its most recent year-to-date financial statements prepared in conformity with GAAP for certification and funding eligibility. The CDFI Fund also requires nonprofit and for-profit nondepository CDFIs receiving awards to annually submit financial statements—including information on financial position, operations, activities, and cash flows—that have been audited by an independent certified public accountant. However, only a subset of CDFIs receives CDFI Fund awards and is subject to such reporting.

In addition to financial statements of individual nondepository CDFIs, other sources can provide information on the financial performance of nondepository CDFIs overall or individually. For example, the CDFI Fund reports on its analysis of financial data from nondepository CDFIs. The CDFI Snapshot Analysis for fiscal year 2012 (the most recent available at the time of our review) notes that community development loan funds, one type of nondepository CDFI, had rates of loan loss (loans that may prove uncollectible) of 1 percent, which compared favorably with depository CDFIs and mainstream financial institutions.<sup>18</sup> A national network of CDFIs reported that its members' annual net charge-off rate (debts an entity is unlikely to collect) was the same as for all FDIC-

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<sup>16</sup>A Federal Financial Institutions Examination Council Call Report (officially known as the Consolidated Report of Condition and Income) must be filed by all FDIC-insured depository institutions on a quarterly basis. Insured credit unions must file quarterly Call Reports with NCUA. An NCUA Call Report may reflect regulatory accounting principles other than GAAP if the credit union has total assets of less than \$10 million (except that a federally insured state-chartered credit union may be required by its state credit union supervisor to follow GAAP regardless of asset size).

<sup>17</sup>State insurance regulators typically conduct on-site financial solvency examinations every 3 to 5 years. Insurance companies file annual National Association of Insurance Commissioners statements with their state regulators.

<sup>18</sup>Of the 296 community development loan funds in the sample of 350 CDFIs, 253 provided loan loss rates. See Department of the Treasury, CDFI Fund, Office of Financial Strategies and Research, *CDFI Snapshot Analysis: Fiscal Year 2012* (Washington, D.C.: April 2014). The CDFI Fund notes that data were self-reported by community development loan funds and published data were based on validation reporting rules and cleansing protocols.



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insured institutions in fiscal year 2012.<sup>19</sup> It also noted that its members had provided more than \$33 billion in cumulative financing for community development activities from their inception through the end of fiscal year 2012. This financing, the network reported, helped to create or maintain nearly 600,000 jobs, support the development or rehabilitation of more than 960,000 housing units, and start or expand nearly 94,000 businesses and microenterprises. And, for a fee, a community development loan fund can be assessed by an independent third party, and receive a financial strength and performance rating.<sup>20</sup> The third party rates a CDFI using a methodology similar to that used by banking regulators.

In the case of financial failure, nondepository CDFIs and depository members also undergo different processes for liquidating assets to repay the FHLBanks for any advances. Depository members, including depository CDFIs, are insured by FDIC or NCUA, which means that FDIC or NCUA would serve as the receiver in the event of failure.<sup>21</sup> In a typical bank or thrift failure, FDIC, acting as receiver, is responsible for outstanding advances of the failed institution. FDIC will facilitate a purchase and assumption transaction with another financial institution or sell the failed institution's assets, including collateral that had been pledged to secure the advances, to mitigate losses to FDIC's Deposit

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<sup>19</sup>See Opportunity Finance Network (OFN), *Opportunity Finance Institutions Side by Side, Fiscal Year 2012 OFN Member Data Analysis/Fifteenth Edition* (Philadelphia, Pa.). The primary source of data for this publication was OFN's Fiscal Year 2012 Annual Member Survey. The survey was sent to all CDFIs that were network members as of August 31, 2013; 200 members completed the survey. OFN supplemented survey data with publicly available data for one CDFI, and new member application data for 8 CDFIs that became members after the survey was conducted. The publication presents data points for as many as 209 CDFIs.

<sup>20</sup>The CDFI Assessment and Ratings System (known as CARS®) is a proprietary tool owned by Aeris, an information service for community investors. As of March 2015, Aeris had rated more than 100 CDFIs. The tool assesses a nondepository CDFI's condition in five areas: capital, asset quality, management, earnings, and liquidity. Each component is rated on a scale of 1 to 5, with 1 being the best. The component ratings are then used to develop a composite rating of 1 to 5. This rating methodology is based on the CAMELS analysis used by regulators to rate banks.

<sup>21</sup>FHLBanks generally have priority over all other creditors, including FDIC, to obtain the collateral necessary to protect against losses on their outstanding advances. The procedures for liquidating an insurance company vary from state to state.

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Insurance Fund.<sup>22</sup> Because nondepository CDFIs are not federally or state insured, according to FHFA, the FHLBanks likely would go through the federal bankruptcy process to settle claims should a nondepository CDFI with FHLBank advances fail.

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## Collateral Requirements Pose Greatest Challenge for Nondepository CDFIs

Collateral requirements (which must be met to obtain advances) rather than the membership requirements themselves can discourage nondepository CDFIs from seeking FHLBank membership. Because regulations allow the FHLBanks to set their own thresholds for meeting some membership requirements, the requirements varied. The rates of nondepository CDFI membership also varied by FHLBank and were low. The FHLBanks generally impose collateral requirements on nondepository CDFIs that are comparable to those imposed on depository members categorized as higher risk and in some cases, comparable to those imposed on insurance companies. Officials from the nondepository CDFIs we interviewed generally cited steep haircuts (discounts) and the availability of eligible collateral as the primary challenges to obtaining advances; in addition, some viewed the requirements as a disincentive to seeking membership (because advances are a primary benefit of membership).

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## Although FHLBanks Had Varying Thresholds for Some Membership Requirements, Most Nondepository CDFIs We Interviewed Were Able to Meet the Requirements

### Certain Membership Requirements Varied

While nondepository CDFIs must meet seven standards for FHLBank membership, the thresholds the FHLBanks set for meeting certain of the requirements varied. The Federal Home Loan Bank Act and FHFA's regulations establish the membership requirements for nondepository CDFIs. Nondepository CDFIs must

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<sup>22</sup>FDIC could not sell the assets the failed institution had pledged to the FHLBank until FDIC had fully satisfied or repaid the failed institution's outstanding credit obligations to the FHLBank.

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- be duly organized under tribal law, or the laws of any state or the United States.
  - be certified by the CDFI Fund.
  - make long-term home mortgage loans, which are defined by statute to include loans secured by first liens on residential real property. Under FHFA regulations, institutions satisfy this requirement if they originate or purchase long-term first mortgage loans on single-family or multifamily residential property, or certain farm or business property that also includes a residence, or purchase mortgage pass-through securities representing an undivided ownership in such loans. By regulation, FHFA has defined “long-term” loans to include those with an original term to maturity of 5 years or more.
  - be in a financial condition that would allow advances to be safely made to it. FHFA developed four financial condition standards for the FHLBanks to use in their assessments—a net asset ratio of at least 20 percent; positive average net income over the preceding 3 years; a ratio of loan loss reserves to loans and leases 90 days or more delinquent of at least 30 percent; and an operating liquidity ratio of at least 1.0 for the 4 most recent quarters, and for 1 or both of the 2 preceding years.<sup>23</sup> If the nondepository CDFI met the standards, it would be presumed to be financially sound, and satisfy the requirement. If the CDFI did not meet one or more standards, the CDFI may offer a rebuttal and the FHLBank would perform a separate analysis to determine if the CDFI was financially sound.
  - have management whose character is consistent with sound and economical home financing. Under FHFA’s regulations, an applicant meets this requirement if it certifies to the FHLBank that neither the CDFI nor its senior officials have been the subject of any criminal, civil, or administrative proceedings reflecting upon creditworthiness, business judgment, or moral turpitude in the past 3 years and that

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<sup>23</sup>Net asset ratio is calculated as the residual value of assets over liabilities. Net income, also called earnings, is calculated as gross revenues less total expenses. Loan loss reserves are the amount reserved for loans expected to be uncollectible. Liquidity is calculated with the numerator of the ratio being unrestricted cash and cash equivalents and the denominator of the ratio being the average quarterly operating expense for the 4 most recent quarters. Net asset ratio, net income, and loan loss reserves are calculated based on information derived from the applicant’s most recent financial statement.

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there are no known potential criminal, civil, or administrative monetary liabilities, lawsuits, or unsatisfied judgments arising within the past 3 years that are significant to the applicant's operations.

- have a home financing policy that is consistent with sound and economical home financing. Under FHFA regulations, applicants meet this requirement if they provide a written justification, acceptable to the FHLBank, explaining how and why their home financing policy is consistent with the FHLBank System's housing finance mission.
- have mortgage-related assets that reflect a commitment to housing finance. They are not required to meet the statutory requirement that applies to certain insured depository institutions to hold at least 10 percent of their assets in residential mortgage loans to be eligible for FHLBank membership.

In addition, the FHLBanks also must require all new members to purchase capital stock.

The FHLBanks have discretion in developing rules to assess compliance with some of the listed requirements. For example, the FHLBanks can set thresholds (such as dollar amounts or percentages) to satisfy requirements for which FHFA has not set thresholds—such as the requirement for making long-term home mortgage loans and the requirement to hold mortgage-related assets.<sup>24</sup> Each FHLBank also can develop its own requirement for membership stock purchases, subject to FHFA approval. We reviewed the three requirements for which the FHLBanks have discretion in making rules and found that the requirements varied across the FHLBanks.

**Making long-term mortgages.** Eight of the 12 FHLBanks we reviewed had not developed a threshold for nondepository CDFIs to satisfy the long-term mortgage requirement, while four had specified a dollar amount or percentage of assets in long-term mortgage loans. FHFA expects that

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<sup>24</sup>In September 2014, FHFA issued a proposed rule that would change the FHLBank membership requirements. For example, the proposed rule would establish a new quantitative test requiring all members, including nondepository CDFIs, to hold 1 percent of their assets in home mortgage loans on an ongoing basis. Because this new ongoing quantitative asset requirement would subsume the existing regulatory membership eligibility requirement that CDFIs and other nondepositories hold an unspecified amount of undefined "mortgage-related assets" at the time of application for membership, the rule would also delete the latter requirement. See 79 Fed. Reg. 54847 (Sept. 12, 2014).

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in assessing the applicant, the FHLBanks will assess the extent to which nondepository CDFIs have a commitment to housing finance requirements in light of their unique mission and community development orientation. The four FHLBanks that had quantitative minimums had minimum requirements that ranged from \$1,000 to \$1 million in dollar amounts, and from 1 percent to 2 percent of total assets. One FHLBank's stated policy included an exemption from its particular minimum requirement for nondepository CDFIs that plan to incorporate long-term mortgage loans into future business strategies. Another FHLBank that had a dollar minimum recently gave a nondepository CDFI an exemption from the minimum requirement based on the assessment that the CDFI had significant commitment to housing in accordance with regulatory and membership requirements. For the remaining eight FHLBanks that did not set a minimum requirement, nondepository CDFIs can satisfy the long-term mortgage requirement by documenting that they have originated or purchased more than one such loan or qualifying mortgage investment.

**Mortgage-related assets.** Four of the 12 FHLBanks we reviewed did not have minimum requirements for the mortgage-related asset requirement, 5 had quantitative and qualitative measures (such as an assessment of the CDFI's housing-related activities and mission), and 3 had only quantitative measures.<sup>25</sup> The highest minimum quantitative requirement for mortgage-related assets as a percentage of total assets was 10 percent. The three FHLBanks with only quantitative requirements had the lowest requirements, with one FHLBank requiring two mortgage-related assets, another requiring \$1,000 in mortgage-related assets, and another requiring the lower of 1 percent of total assets or \$10 million in mortgage-related assets.

**Stock purchases.** The amount of stock that members must purchase varied according to each FHLBank's funding strategy (see table 2). FHLBank members must hold a certain amount of membership capital stock as a continuing condition of membership. Each FHLBank determines as a part of its capital plan the amounts that all members must purchase in membership capital stock and sets its requirement based on the FHLBank's business model. Five of the 12 FHLBanks we reviewed calculated the membership stock purchase as a percentage of

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<sup>25</sup>Five FHLBanks have policies that allow them discretion to consider other variables if a nondepository CDFI does not meet the quantitative requirement.

the member's total assets. The other 7 FHLBanks calculated the purchase as a percentage of a specific asset category, such as mortgage-related assets or certain assets eligible to be pledged as collateral.

**Table 2: Requirements for Purchases of Membership Stock by FHLBank, as of November 2014**

FHLBank	Stock purchase percentage	Assets to which the stock purchase percentage is applied <sup>a</sup>	Minimum investment	Maximum investment
Atlanta	0.09%	Total	No minimum <sup>b</sup>	\$15 million
Boston	0.35	Subset	\$10,000	25 million
Chicago	1.00	Subset	10,000	Lesser of 9.9% of FHLBank's total outstanding capital stock or \$250 million
Cincinnati	0.03 to 0.15	Total	1,000	25 million
Dallas	0.04	Total	1,000	7 million
Des Moines	0.12	Total	10,000	10 million
Indianapolis	1.00	Subset	1,000	35 million
New York	0.15	Subset	1,000	No maximum
Pittsburgh	0.10	Subset	10,000	45 million
San Francisco	1.00	Subset	100	25 million
Seattle	0.50	Subset	500	15 million
Topeka	0.10	Total	1,000	500,000

Source: GAO analysis of FHLBank information. | GAO-15-352

<sup>a</sup>Subset is used when the FHLBank calculates the membership stock purchase percentage using more narrowly defined assets, such as mortgage-related assets, rather than total assets.

<sup>b</sup>Stock transactions for FHLBank-Atlanta occur in \$100 increments.

The FHLBanks also require members to purchase activity-based stock. That is, members must acquire a specific amount of stock based on the product—such as advances or letters of credit—the FHLBank provided to that member. The purchases are specified as a percentage of the dollar amount of each transaction the member conducted with the FHLBank. For example, among the 12 FHLBanks, the purchase requirements on advances ranged from 2 percent to 5 percent. For instance, if a member had a \$2 million advance transaction with the FHLBank, it would have to purchase from \$40,000 to \$100,000 in capital stock.

### Most CDFIs Were Able to Meet Membership Requirements

While FHLBank and CDFI industry officials we interviewed cited several membership requirements that could pose a challenge for nondepository CDFI applicants (including financial condition, long-term home mortgage

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loan, mortgage-related assets, and stock purchase requirements), most of the nondepository CDFIs we interviewed were able to meet these requirements or stated that they would be able to meet the requirements.

**Financial condition requirements.** Officials we interviewed from 9 of the 12 nonmember nondepository CDFIs stated that they would be able to meet the financial condition standards, while 2 stated that they would potentially face challenges with the financial condition standards.<sup>26</sup> In addition to interviewing officials from nondepository CDFIs that were nonmembers, we reviewed the applications of the 27 nondepository CDFIs that were members as of September 2014. Seven of the 27 nondepository CDFIs did not meet at least one of the financial condition standards at the time of their application, but made successful rebuttals and became members.<sup>27</sup>

**Making long-term mortgages.** Of the 12 nonmember nondepository CDFIs we interviewed, officials from 1 cited the “makes long-term home mortgage loans” requirement as a challenge for membership. In addition, officials from 1 of the 10 member nondepository CDFI we interviewed cited this as a challenge, but noted that they received an exemption from the minimum quantitative requirement imposed by the FHLBank. The officials from the remaining 11 nonmember and 9 member CDFIs did not identify this requirement as a challenge. Officials from two FHLBanks stated that CDFIs in general may face challenges meeting this requirement, as some nondepository CDFIs may not make or hold long-term home mortgage loans if they are not involved in mortgage lending.

**Mortgage-related assets.** Although the mortgage-related asset requirement varies among the FHLBanks, none of the officials from the 12 nonmember nondepository CDFIs we interviewed stated that they would face challenges meeting this requirement.

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<sup>26</sup>Officials at one CDFI stated that they were not sufficiently familiar with the membership requirements to know if the CDFI could meet the requirements.

<sup>27</sup>Four of the seven CDFIs did not meet the net asset ratio standard, three of the seven CDFIs did not meet the loan loss reserves standard, two of the seven CDFIs did not meet the positive net income standard, and two of the seven CDFIs did not meet the liquidity ratio standard. Four of the seven CDFIs failed two financial condition standards, with a total of 11 standards failed among seven CDFIs.

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**Stock-purchase requirements.** Officials from 1 of the 12 nonmember CDFIs we interviewed stated that the amount of membership stock they would be required to purchase was cost prohibitive, while officials from the 10 member CDFIs we interviewed stated that the amount required was not a challenge to membership. Nondepository member CDFIs we interviewed were able to purchase the required amount of membership stock. Officials from one nonmember nondepository CDFI in the FHLBank-Chicago district said that the CDFI was approved for membership, but did not become a member because the stock purchase requirement was too high. FHLBank-Pittsburgh recently amended its capital plan by lowering the membership and activity-based stock purchase calculations, citing benefits to CDFIs. In addition, FHLBank-Chicago recently reduced its minimum membership stock purchase requirement to make it less costly for nondepository CDFIs and others to join. (We discuss these and other changes later in this report.)

#### Rates of Nondepository CDFI Membership Were Low

The rates of nondepository CDFI membership generally were low, ranging from 2.08 percent to 15.38 percent of nondepository CDFIs in each FHLBank district (see fig. 2). As of December 31, 2014, 30 of the 522 nondepository CDFIs were FHLBank members, and 6 of the 12 FHLBanks had membership rates of less than 5 percent for the nondepository CDFIs in their districts. The number of nondepository CDFI members has increased every year since the first joined in 2010. Forty percent (12 of 30) of the current nondepository CDFI members joined the FHLBank System in 2014. As of the end of 2014, all 12 FHLBanks had at least one nondepository CDFI member; 2 approved their first nondepository CDFI member in 2013 and another 3 did so in 2014.



**Figure 2: Rates of Nondepository CDFI Membership by FHLBank District, as of December 31, 2014**

	Cumulative number of non-depository CDFI members					Total CDFIs in district	Membership rate
	2010	2011	2012	2013	2014		
Atlanta	1	1	1	1	2	73	2.74%
Boston	0	0	0	1	4	48	8.33
Chicago	0	1	1	1	1	24	4.17
Cincinnati	1	3	4	4	4	30	13.33
Dallas	0	0	2	3	4	45	8.89
Des Moines	0	1	1	1	1	48	2.08
Indianapolis	0	0	0	1	2	13	15.38
New York	0	0	1	2	2	63	3.17
Pittsburgh	0	0	0	0	1	32	3.13
San Francisco	0	2	3	4	5	68	7.35
Seattle	0	0	0	0	2	53	3.77
Topeka	0	0	0	0	2	25	8.00
<b>Total</b>	<b>2</b>	<b>8</b>	<b>13</b>	<b>18</b>	<b>30</b>	<b>30 (members) + 492 (nonmembers) = 522</b>	<b>5.75%</b>

Members
  Nonmembers
 CDFI = community development financial institution

Source: GAO analysis of FHFA membership database and CDFI Fund data. | GAO-15-352

Note: The number of nondepository CDFI members each year is a cumulative number and represents nondepository CDFIs that had been approved for membership and purchased stock by December 31, 2014. The membership rate is calculated by dividing the number of nondepository CDFI members by the total number of nondepository CDFIs in the FHLBank district.

According to FHFA officials, some nondepository CDFIs may not be good candidates for FHLBank membership. They noted that the majority of nondepository CDFIs make nonhousing loans such as microloans, small business loans, and commercial loans. In addition, FHFA officials stated that many of the nondepository CDFIs engaged in housing-related activities have low asset volumes.

### Nondepository CDFIs Are Subject to Comparatively More Stringent Collateral Requirements, Which Can Be a Disincentive for Obtaining Membership

Due to the differences between nondepository CDFIs and other FHLBank members discussed earlier, representatives from the FHLBanks stated that nondepository CDFIs have certain risks that depository members do not have. The risks cited included the lack of supervision by a regulator and uncertainty related to the liquidation process in the event of insolvency. As noted previously, the FHLBanks are required by statute and FHFA regulations to develop and implement collateral standards and other policies to mitigate the risk of default on outstanding advances. To address risks associated with nondepository CDFIs, the FHLBanks can place limits on eligible collateral and generally impose collateral requirements on nondepository CDFIs seeking advances that are

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Eligible Collateral for  
Nondepository CDFIs Varied  
among FHLBanks

comparable to those imposed on depository members categorized as higher risk and, in some cases, insurance companies. Some of the CDFIs and FHLBanks we interviewed cited these collateral requirements as a disincentive for nondepository CDFI membership.

Although they are allowed by regulation to accept certain types of collateral from all of their members, some FHLBanks have chosen to limit the types of eligible collateral that nondepository CDFIs can pledge. (This is also sometimes the case for other nondepository members such as insurance companies.)

- FHLBanks can accept FHLBank deposits as collateral.
- The securities collateral FHLBanks can accept includes U.S. Treasury and agency securities, U.S. agency mortgage-backed securities, and privately issued mortgage-backed securities (including residential and commercial).<sup>28</sup>
- The types of mortgage collateral that FHLBanks can accept include single-family and multifamily mortgage loans; mortgage or other loans issued, insured, or guaranteed by the U.S. government or its agencies; commercial real estate loans; and home equity loans or lines of credit.<sup>29</sup>

Nondepository CDFIs are eligible to pledge FHLBank deposits, securities, and mortgage loans as collateral for advances at all 12 FHLBanks. During

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<sup>28</sup>12 CFR § 1266.7. Eligible types of securities collateral for pledge to FHLBanks consist of (1) privately issued mortgage-backed securities; (2) agency securities that are issued, insured, or guaranteed by the U.S. government, or any agency thereof, including mortgage-backed securities issued or guaranteed by Freddie Mac, Fannie Mae, Ginnie Mae, or any other agency of the U.S. government; and (3) securities backed by, or representing an equity interest in, mortgages or other loans insured or guaranteed by the United States or any U.S. agency.

<sup>29</sup>12 CFR § 1266.7. Eligible types of loan collateral for pledge to the FHLBanks consist of (1) mortgage loans that are fully disbursed, whole first mortgage loans on improved residential real property not more than 90 days delinquent; (2) mortgages or other loans that are insured or guaranteed by the United States or any U.S. agency, regardless of delinquency status; and (3) other real estate-related collateral provided that it has a readily ascertainable value, can be reliably discounted to account for liquidation and other risks, can be liquidated in due course, and the FHLBank can perfect a security interest in such collateral. Other real estate-related collateral includes but is not limited to second mortgage loans, including home equity loans; commercial real estate loans; and mortgage loan participations.

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the course of our work, three FHLBanks—Atlanta, New York, and Pittsburgh—changed their policies to allow mortgage loans as eligible collateral from nondepository CDFIs. Pittsburgh changed its policies in August 2014, New York in September 2014, and Atlanta in December 2014. All the other FHLBanks have had policies that allowed mortgage loans as eligible collateral from nondepository CDFIs since nondepository CDFIs became eligible for membership in 2010. Officials from FHLBanks in Atlanta, New York, and Pittsburgh stated that due to the different risks posed by nondepository CDFIs, they initially took conservative stances on accepting loan collateral. The risks they cited included the lack of a clear resolution mechanism in the case of bankruptcy and the FHLBank not being able to obtain blanket liens on pledged collateral.

Within the general collateral categories (such as securities and mortgage loans), each FHLBank can impose specific collateral eligibility requirements, such as the quality of the collateral. For example, for nondepository CDFIs, one FHLBank disallows nonagency mortgage-backed securities, another FHLBank disallows commercial real estate collateral, and five FHLBanks disallow home equity lines of credit or home equity loans. At two FHLBanks, nondepository CDFIs can pledge mortgage loan collateral only if the CDFIs have certain credit ratings.

### Collateral Requirements for Nondepository CDFIs Are Comparable to Those for Higher-Risk Institutions

The collateral requirements—specifically, the pledge method and haircuts—applicable to nondepository CDFIs seeking advances are comparable to those generally imposed on depository members categorized as higher risk and, in some cases, to those imposed on insurance companies. Based on our review of each FHLBank’s policies, all FHLBanks evaluate the creditworthiness and financial condition of their members, including nondepository CDFIs. Factors included in many of the evaluations are capital adequacy, asset quality, management quality, earnings, and liquidity. Additionally, the FHLBanks (with the exception of Topeka) assign credit ratings to their depository members that indicate the creditworthiness and financial condition of these members.<sup>30</sup> Of the 11 FHLBanks that assign credit ratings to depository members, 9 also assign credit ratings to nondepository CDFIs, with 2 (Atlanta and San Francisco) using a separate rating system specific to nondepository CDFIs. The remaining FHLBanks (New York and Indianapolis) do not assign credit

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<sup>30</sup>FHLBank-Topeka does not assign specific credit ratings to members, but evaluates financial performance based on a set of criteria and assigns a pass or fail rating.

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ratings to nondepository CDFIs. While the metrics and methodology used to evaluate members differ, policies across FHLBanks generally reflect differential treatment between depository institutions and nondepository CDFIs (and other nondepository institutions such as insurance companies). For example, all FHLBanks require nondepository members to deliver collateral but generally only depository members with low credit ratings are required to list or deliver collateral.

The FHLBanks differed in the extent to which they varied haircuts (discounts) for nondepository CDFIs and depository institutions.<sup>31</sup> For securities collateral, eight FHLBanks imposed the same haircut on nondepository CDFIs as on depository members for all eligible types of securities collateral. In contrast, four imposed higher haircut ranges on nondepository CDFIs. For loan collateral,

- six FHLBanks generally applied the same haircuts to nondepository CDFIs and depository institutions. One applied a higher-range haircut for single-family mortgages to nondepository CDFIs than to depository institutions;
- five FHLBanks applied higher haircut ranges to nondepository CDFIs than to depository institutions; and
- another FHLBank applied the lower end of the haircut range to nondepository CDFIs.

FHLBanks generally varied the haircut based on the types and quality of collateral, credit score or financial condition of the member, and pledge method (for loans).<sup>32</sup> In general, haircuts were higher for collateral with lower ratings or of lower quality. See tables 3 and 4 for the specific haircuts each FHLBank imposed on nondepository CDFIs and depository institutions for securities and loan collateral.<sup>33</sup> In all cases, each FHLBank may change these requirements at its discretion. See appendix II for

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<sup>31</sup>In some cases, the FHLBanks treat all nondepository institutions the same; therefore, the haircuts applied to insurance companies are the same as those of nondepository CDFIs.

<sup>32</sup>All FHLBanks require securities to be delivered to the FHLBank or third-party custodian; the variation in pledge method is only applicable for loan collateral.

<sup>33</sup>The haircut for cash and FHLBank deposits is 0 percent across all FHLBanks

more information on each FHLBank's credit rating system and collateral requirements for advances, and how they may differ for nondepository CDFIs and depository institutions.

**Table 3: Percentage Haircut (Discount) for Selected Securities Collateral for Depository Institutions and Nondepository CDFIs by FHLBank, as of December 2014**

FHLBank	Securities collateral types					
	U.S. Treasury and agency securities <sup>a</sup>		Nonagency MBS		Nonagency, commercial MBS	
	DIs	CDFIs	DIs	CDFIs	DIs	CDFIs
1	3-14% <sup>b</sup>	8-19% <sup>b</sup>	21-28% <sup>b</sup>	26-33% <sup>b</sup>	21-33% <sup>b</sup>	26-38% <sup>b</sup>
2 <sup>c</sup>	1-12 <sup>b</sup>	1-12 <sup>b</sup>	10-19 <sup>b</sup>	10-19 <sup>b</sup>	7-21 <sup>b</sup>	7-21 <sup>b</sup>
3 <sup>c</sup>	3-16 <sup>b,d</sup>	3-16 <sup>b,d</sup>	10-47 <sup>b,d</sup>	10-47 <sup>b,d</sup>	13-56 <sup>b,d</sup>	13-56 <sup>b,d</sup>
4 <sup>e,c</sup>	3-7 <sup>b</sup>	3-7 <sup>b</sup>	50	<sup>f</sup>	15-50 <sup>b</sup>	15-50 <sup>b</sup>
5	3	8-11 <sup>b</sup>	10-28 <sup>d</sup>	30	10-28 <sup>d</sup>	30
6	3-5 <sup>b</sup>	3-5 <sup>b</sup>	15-30 <sup>b</sup>	15-30 <sup>b</sup>	15-30 <sup>b</sup>	15-30 <sup>b</sup>
7	2-5 <sup>b</sup>	2-5 <sup>b</sup>	2 <sup>g</sup>	2 <sup>g</sup>	2 <sup>g</sup>	2 <sup>g</sup>
8	5-6 <sup>b</sup>	5-6 <sup>b</sup>	10-12 <sup>b</sup>	10-12 <sup>b</sup>	12-18 <sup>b</sup>	12-18 <sup>b</sup>
9	1-15 <sup>b</sup>	2-21 <sup>b,d</sup>	13-34 <sup>b,d</sup>	39-57 <sup>b,d</sup>	14-41 <sup>b,d</sup>	44-67 <sup>b,d</sup>
10 <sup>c</sup>	2-4 <sup>b,d</sup>	2-12 <sup>b,d</sup>	10	10-30 <sup>b,d</sup>	5-10 <sup>b</sup>	5-30 <sup>b,d</sup>
11	1-7 <sup>b</sup>	1-7 <sup>b</sup>	20-45 <sup>b</sup>	20-45 <sup>b</sup>	20-25 <sup>b</sup>	20-25 <sup>b</sup>
12 <sup>c</sup>	5-11 <sup>b</sup>	5-11 <sup>b</sup>	9-45 <sup>b</sup>	9-45 <sup>b</sup>	13-47 <sup>b</sup>	13-47 <sup>b</sup>

Source: GAO analysis of FHLBank information. | GAO-15-352

MBS = mortgage-backed securities; DI = depository institution; CDFI = nondepository community development financial institution

Note: The haircuts for different FHLBanks are not comparable. The FHLBanks provided discrete haircut values depending on factors such as type and quality of collateral and credit ratings; these haircut values are grouped into a range. The quality of collateral accepted may differ across FHLBanks. For example, one FHLBank accepts commercial mortgage-backed securities that are rated AA and higher, while another accepts commercial mortgage-backed securities that are only rated AAA. We did not include all securities collateral types accepted by the FHLBanks because they were only mentioned in some FHLBanks' documents. For example, we excluded second mortgage-backed securities; student-loan asset-backed securities; and municipal, state, or local government securities. The information above is not inclusive of all information that the FHLBanks may take into consideration in determining a haircut. For example, based on a field review of the pledged collateral, the FHLBank may impose additional haircuts. Thus, the haircuts presented in this table are minimum haircuts.

<sup>a</sup>We excluded certain securities from our analysis because they were only mentioned in some FHLBanks' documents.

<sup>b</sup>The specific type of collateral, collateral rating or collateral quality, or the maturity of collateral determines where the haircut falls within the range. Generally, a higher haircut is given to collateral with a longer maturity or lower quality.

<sup>c</sup>For FHLBanks 2, 3, 4, 10, and 12, the haircuts for insurance companies are the same as those of nondepository CDFIs. For FHLBanks 2, 3, 4, and 12, these haircuts are also the same as depository institutions.

<sup>d</sup>The credit score or financial condition of the member determines where the haircut falls within the range.

<sup>e</sup>For nondepository CDFIs that execute an agreement to establish a specific lien on assets pledged to Bank 4, discounts applied to securities collateral are increased by 20 percent. For example, a discount of 10 percent increases to 12 percent.

<sup>f</sup>Collateral is ineligible.

<sup>g</sup>For Bank 7, the haircut for nonagency MBS and commercial MBS starts at the haircut indicated in the table and will vary. However, the FHLBank document does not specify how much the variation could be.

**Table 4: Percentage Haircut (Discount) for Selected Loan Collateral for Depository Institutions and Nondepository CDFIs by FHLBank, as of December 2014**

FHLBank	Mortgage loan collateral types									
	Single-family residential mortgages		Multifamily residential mortgages		Commercial real estate		Home equity loans/lines of credit		Government guaranteed loans	
	DIs	CDFIs	DIs	CDFIs	DIs	CDFIs	DIs	CDFIs	DIs	CDFIs
1 <sup>a,b</sup>	10%	15% <sup>c</sup>	20%	25% <sup>c</sup>	25%	30% <sup>c</sup>	15%	<sup>d</sup>	— <sup>e</sup>	— <sup>e</sup>
2 <sup>b</sup>	23-34 <sup>f</sup>	23-34 <sup>c,f</sup>	35	35 <sup>c</sup>	38	38 <sup>c</sup>	38	<sup>d</sup>	7-13 <sup>f</sup>	7-13 <sup>c,f</sup>
3 <sup>b</sup>	20-45 <sup>f</sup>	20-45 <sup>c,f</sup>	28-43 <sup>f</sup>	28-43 <sup>c,f</sup>	33-45 <sup>f</sup>	<sup>d</sup>	14-48 <sup>f</sup>	<sup>d</sup>	9-13 <sup>f</sup>	9-13 <sup>c,f</sup>
4 <sup>b</sup>	20-40 <sup>f,g</sup>	25-40 <sup>c,f</sup>	27 <sup>h</sup>	27 <sup>c</sup>	35 <sup>h</sup>	35 <sup>c</sup>	50 <sup>h</sup>	50 <sup>c</sup>	10-25 <sup>f,g</sup>	10-25 <sup>c,f</sup>
5 <sup>i</sup>	6-36 <sup>f,g,j</sup>	14-25 <sup>c,f</sup>	21-35 <sup>j</sup>	27 <sup>c</sup>	21-36 <sup>j</sup>	27 <sup>c</sup>	5-40 <sup>f,g,j</sup>	<sup>d</sup>	— <sup>e</sup>	— <sup>e</sup>
6 <sup>k</sup>	20-25 <sup>g</sup>	50 <sup>c</sup>	30-35 <sup>g</sup>	50 <sup>c</sup>	30-35 <sup>g</sup>	50 <sup>c</sup>	40-45 <sup>g</sup>	50 <sup>c</sup>	20-35 <sup>f,g</sup>	50 <sup>c</sup>
7 <sup>b</sup>	10-25 <sup>g</sup>	10-25 <sup>c,j</sup>	25	25 <sup>c</sup>	30	30 <sup>c</sup>	55	<sup>d</sup>	N/A <sup>l</sup>	N/A <sup>l</sup>
8	22-46 <sup>f</sup>	22-46 <sup>c,f</sup>	30-62 <sup>f</sup>	30-62 <sup>c,f</sup>	27-62 <sup>f</sup>	27-62 <sup>c,f</sup>	25-44 <sup>f</sup>	25-44 <sup>c,f</sup>	11-15 <sup>f</sup>	11-15 <sup>c,f</sup>
9	6-33 <sup>f,g,j</sup>	33 <sup>c,j</sup>	13-47 <sup>f,g,j</sup>	39-43 <sup>c,j</sup>	9-39 <sup>f,g,j</sup>	33-36 <sup>c,j</sup>	13-43 <sup>f,g,j</sup>	N/A <sup>l</sup>	N/A <sup>l</sup>	N/A <sup>l</sup>
10 <sup>b</sup>	5-35 <sup>f,g,j</sup>	5-35 <sup>c,f,j</sup>	22-45 <sup>f,g,j</sup>	22-45 <sup>c,f,j</sup>	30-50 <sup>f,g,j</sup>	30-50 <sup>c,f,j</sup>	20-70 <sup>f,g,j</sup>	20-70 <sup>c,f,j</sup>	15	15 <sup>c</sup>
11	8-31 <sup>g,j</sup>	23 <sup>c</sup>	10-31 <sup>g,j</sup>	21 <sup>c</sup>	12-35 <sup>g,j</sup>	24 <sup>c</sup>	18-44 <sup>g,j</sup>	36 <sup>c</sup>	— <sup>e</sup>	— <sup>e</sup>
12 <sup>b</sup>	20-31 <sup>g</sup>	20 <sup>c</sup>	36-43 <sup>g</sup>	36 <sup>c</sup>	43-50 <sup>g</sup>	43 <sup>c</sup>	33-60 <sup>g</sup>	33 <sup>c</sup>	— <sup>e</sup>	— <sup>e</sup>

Source: GAO analysis of FHLBank information. | GAO-15-352

DI = depository institution; CDFI = nondepository community development financial institution; N/A = not applicable

Note: The haircuts for different FHLBanks are not comparable. The FHLBanks provided discrete haircut values depending on factors such as type and quality of collateral and credit ratings; these haircut values are grouped into a range. The quality of collateral accepted may differ across FHLBanks. For example, one FHLBank specifies that it accepts conventional single-family residential mortgage loans, while another provides a range for traditional, subprime, and nontraditional mortgage loans. We did not include all loan collateral types accepted by the FHLBanks because they were only mentioned in some FHLBanks' documents. We excluded agricultural real estate loans, land loans, construction loans, and student loans. The information above is not inclusive of all information that the FHLBanks may take into consideration in determining a haircut. For example, based on a field review of the pledged collateral, the FHLBank may impose additional haircuts. Thus, the haircuts presented in this table are minimum haircuts. Four FHLBanks also vary the basis (e.g., market value, unpaid principal balance) for determining loan collateral values in relation to the pledge method.

<sup>a</sup>Nondepository CDFIs cannot pledge second-lien loans to Bank 1 while depository institutions can. The haircut in this table includes only the first-lien loans for comparability between depository institutions and nondepository CDFIs. Additionally, the FHLBank established a separate and higher

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haircut for members that have not undergone an on-site review. We did not include those haircut requirements.

<sup>b</sup>For FHLBanks 1, 2, 3, 4, 7, 10, and 12, the haircuts for insurance companies are generally the same as those of nondepository CDFIs. For FHLBanks 2, 3, 7, and 10, these haircuts are also the same as depository institutions.

<sup>c</sup>The required pledge method is generally delivery.

<sup>d</sup>The collateral is ineligible.

<sup>e</sup>We could not determine this information from the documentation provided by the FHLBanks.

<sup>f</sup>The type, rating, or quality of collateral determines where the haircut falls within the range. Generally, a higher haircut is given to collateral with a lower quality.

<sup>g</sup>The pledge method affects where the haircut falls within the range. In some cases, the haircut applicable to collateral pledged using listing status may be lower than that of blanket lien status. Delivery may be required based on the financial strength of the member.

<sup>h</sup>The required pledge method is listed reporting.

<sup>i</sup>Bank 5 assigns multifamily residential mortgage and commercial real estate loans one of three levels (levels 1-3) based on reporting requirements from the least level of detail to most level of detail. Additionally, commercial real estate collateral could be standard or special purpose. Nondepository CDFIs are only allowed to pledge standard, level 3 loans. For comparability between nondepository CDFIs and depository institutions, haircuts assigned to level 1 and 2 and special-purpose collateral are excluded in the table. In addition, Bank 5 does not accept loan collateral from nondepository CDFIs with the highest credit risk according to its internal rating system.

<sup>j</sup>The member's credit score or financial condition determines where the haircut falls within the range.

<sup>k</sup>Nondepository CDFIs only may borrow from Bank 6 if they have passable credit ratings according to the FHLBank's internal rating system, unless otherwise approved.

<sup>l</sup>Bank 7 explained that it does not apply different haircuts to government-guaranteed loans; Bank 9 indicated that it did not develop a haircut for nondepository CDFIs for home equity loans/lines of credit and that it does not distinguish between guaranteed and unguaranteed loans.

## Few FHLBanks Had Specific Advance Terms and Conditions for Nondepository CDFIs

Four FHLBanks—Des Moines, New York, Pittsburgh, and San Francisco—had conditions on advance terms and borrowing limits specific to nondepository CDFIs. In general, advance terms and conditions varied widely. For example, FHLBanks offered advances with terms to maturity ranging from overnight to 30 years. FHLBanks may establish an overall credit limit for their borrowers. For example, the overall credit limit for FHLBank-Chicago was 35 percent of a member's total assets. However, the amount a borrower can obtain is also partly dependent upon the amount and value of qualifying collateral available to secure the advance. FHLBanks may impose additional restrictions depending on the financial condition of the borrower, such as restrictions on the type of product, term of advance, and amount of credit available. Examples of specific conditions imposed on nondepository CDFIs by the four FHLBanks include the following:

- FHLBank-Des Moines imposed a maximum amount of borrowing capacity and term available based on member credit ratings. Nondepository CDFIs were subject to a lower borrowing capacity than depository institutions with the same ratings.

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- FHLBank-New York limited the maximum advance term to 5 years for nondepository CDFIs.
  - FHLBank-Pittsburgh limited the maximum advance term to 2 years for nondepository CDFIs.
  - FHLBank-San Francisco had a term limit of 7 years for its nondepository CDFIs.

For more information on each FHLBank's advance terms and borrowing limits for nondepository CDFIs and depository institutions, see appendix III.

#### Lack of Eligible Collateral Viewed as Primary Challenge to Obtaining Advances and Steep Haircuts Viewed as Disincentives

Officials from most of the nondepository CDFIs we interviewed cited access to low interest-rate advances from the FHLBanks as the primary benefit of membership, and some FHLBanks and nondepository CDFIs officials cited collateral requirements as challenges or disincentives to obtaining advances. Officials from three FHLBanks stated that the lack of eligible collateral was a disincentive for nondepository CDFIs seeking membership.

- Officials from 21 (10 members and 11 nonmembers) of the 22 nondepository CDFIs we interviewed cited access to low interest-rate advances from the FHLBanks as the primary benefit of membership.
- Officials from 5 of the 12 nonmember nondepository CDFIs interviewed said that they would not be interested in membership if they could not obtain advances.
- Officials from 10 FHLBanks and 12 (6 members and 6 nonmembers) nondepository CDFIs stated that lack of eligible collateral was a challenge to obtaining advances for nondepository CDFIs. The reasons the officials provided for lack of collateral eligibility included
  - not possessing mortgage-related collateral,
  - not having unencumbered assets (those free and clear of liens or claims by other creditors), and
  - not having quality collateral that met FHLBank standards.
- For example, officials from FHLBank-Chicago stated that most nondepository CDFIs possessed assets, such as small business loans, that did not qualify based on statute and regulation as eligible



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collateral.<sup>34</sup> Officials from four FHLBanks and seven nondepository CDFIs (three members and four nonmembers) stated that the requirement to pledge unencumbered assets was a challenge for nondepository CDFIs. Collateral encumbrance may occur when a CDFI is also a loan consortium that makes loans to borrowers on behalf of its members.<sup>35</sup> Quality of collateral also affected collateral eligibility. For instance, officials from FHLBank-Cincinnati provided an example of a nondepository CDFI member whose collateral consisted exclusively of subprime mortgage loans. Due to the FHLBank's constraints on exposure to subprime residential mortgage loan collateral (no more than 60 percent of borrowing capacity could stem from these loan types), the FHLBank was not able to accept the loans as collateral.

- Steep haircuts were cited as a disincentive to applying for advances. Officials from 6 (2 members and 4 nonmembers) of the 22 nondepository CDFIs we interviewed cited high haircuts as a disincentive for obtaining advances. For example, officials from a nondepository CDFI member said that their haircuts were very steep and that they likely will not obtain advances again unless the FHLBank eased the requirements. Officials from a nonmember nondepository CDFI in another district stated that the haircut was too restrictive.

Officials from all the member nondepository CDFIs we interviewed said that FHLBank membership had not affected their business activities or that they had not considered changing their business activities to better meet the collateral requirements. However, officials from three of the

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<sup>34</sup>The Federal Home Loan Bank Act permits community financial institutions to pledge alternative collateral such as small business, small farm, and small agribusiness loans, and securities representing a whole interest in these secured loans. Community financial institutions are defined as any FHLBank member with deposits insured by FDIC and average total assets below a specified cap. For more information, see GAO, *FHFA Oversight of FHLBank Alternative Collateral*, [GAO-10-792](#) (Washington, D.C.: July 20, 2010). The Small Business and Community Investments Expansion Act of 2015 (H.R. 1355) was introduced in 2015 to allow CDFIs to pledge the types of collateral community financial institutions are eligible to pledge.

<sup>35</sup>A loan consortium is formed by the joining of two or more financial institutions to invest in a pool of funds and make loans to a borrower using participation loans or lines of credit. Investors in a loan consortium share the costs and risks of lending. Each investor allows a prorated draw based on its respective commitment amount and shares any losses proportionally.

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Less Than Half of  
Nondepository CDFI Members  
Have Borrowed from  
FHLBanks

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nonmember nondepository CDFIs we interviewed said that they have been taking actions to obtain assets that could be used as eligible collateral. One of these nonmember nondepository CDFIs was buying mortgage-backed securities to better meet collateral requirements. Additionally, officials from five FHLBanks said that their nondepository CDFI members had changed the structure of certain loans or repositioned their assets to create eligible collateral for advances.

From October 2010 to September 2014, less than half of the nondepository CDFI members obtained advances from the FHLBanks. Six FHLBanks provided 115 advances totaling about \$306.7 million to 12 nondepository CDFIs during this period (see fig. 3). However, two FHLBanks provided 57 advances to four nondepository CDFIs that accounted for almost 98 percent of the total advance amount. Of the 115 advances, approximately 36.5 percent had terms of less than 1 year (including advances with overnight terms), 15.7 percent had terms of more than 1 year to less than 5 years, 44.3 percent had terms of 5 years or longer, and 3.5 percent had open terms.<sup>36</sup>






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<sup>36</sup>Long-term advances only may be made to (1) provide funds to any member for residential housing finance; and (2) provide funds to any community financial institution for small business, small farms, small agribusiness, and community development activities. 12 U.S.C §1430(a)(2). Long-term is defined by FHFA to mean a term to maturity of 5 years or greater. 12 CFR § 1266.1. The advances with open terms originated from FHLBank-San Francisco. With an open term, the advance does not have a stated maturity date. Rather, the advance reprices each day, and interest payments are due at the end of each month. Members have the opportunity each day to pay down their open advances without a prepayment fee.

**Figure 3: Total Advances Made to Nondepository CDFIs by FHLBank District, from October 2010 through September 2014**

	Number of advances	Amount of advances (dollars in millions)	Number of nondepository CDFI members that obtained advances
Atlanta	10	\$183.0	1 of 2
Boston	1	0.2	1 of 3
Chicago	2	3.0	1 of 1
Cincinnati	9	2.1	3 of 4
Dallas	46	2.4	3 of 4
Des Moines	0	0	0 of 1
Indianapolis	0	0	0 of 2
New York	0	0	0 of 2
Pittsburgh	0	0	0 of 0
San Francisco	47	116.0	3 of 5
Seattle	0	0	0 of 2
Topeka	0	0	0 of 1
<b>Total</b>	<b>115</b>	<b>\$306.7</b>	<b>12 of 27<sup>a</sup></b>

**Terms of advance**

-  Overnight
-  <1 year, excluding overnight
-  ≥1 year - <5 years
-  ≥5 years
-  Open<sup>b</sup>

CDFI = community development financial institution

Source: GAO analysis of FHFA membership database and FHLBank information. | GAO-15-352

<sup>a</sup>At the time of our analysis (September 2014), 27 nondepository CDFIs were members of the FHLBank System. Another 3 nondepository CDFIs joined the FHLBank System in November and December 2014, for a total of 30.

<sup>b</sup>The advances with open terms originated from FHLBank-San Francisco. With an open term, the advance does not have a stated maturity date. Rather, the advance reprices each day, and interest payments are due at the end of each month. Members have the opportunity each day to pay down their open advances without a prepayment fee.

## FHFA and FHLBanks Have Made Efforts to Facilitate Broader Participation of Nondepository CDFIs in the FHLBank System

FHFA and FHLBanks have made efforts to broaden the participation of nondepository CDFIs in the FHLBank System. According to FHFA officials, FHFA's final rule implementing the HERA provisions that allow nondepository CDFI membership in the FHLBank System allows for certain flexibilities in meeting membership requirements. FHFA oversight of FHLBanks did not focus on FHLBanks' membership approval process or advance and collateral practices as it relates to nondepository CDFIs and did not identify any safety and soundness concerns or action plans. FHFA and the FHLBanks have undertaken several efforts to help promote membership of nondepository CDFIs in the FHLBank System.

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## FHFA Final Rule on Membership for Nondepository CDFIs Includes Flexibilities

As noted previously, FHFA's final rule to implement HERA provisions on nondepository CDFI membership in the FHLBank System allows for certain flexibilities in meeting membership requirements. In 2009, FHFA drafted a proposed rule that sought to amend the membership regulations and issued it for public comment. The substantive issues raised in the comments on membership focused on the criteria that FHFA proposed for FHLBanks to use in evaluating the financial condition of nondepository CDFIs applying for membership. According to FHFA officials, the CDFI community also was concerned about nondepository CDFIs not meeting basic membership requirements, such as making long-term mortgage loans and carrying mortgage-related assets.

FHFA reviewed the comments and issued a final rule in January 2010. If an applicant cannot meet the presumptive financial conditions, the final FHFA regulations allow nondepository CDFIs to submit additional information demonstrating that the applicant is in sufficiently sound condition to obtain membership and advances. The final rule also did not extend the requirement to demonstrate that 10 percent of their total assets are in residential mortgage loans to nondepository CDFI applicants.

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## Examinations of FHLBanks Found No Safety and Soundness Concerns with Advance Practices

FHFA oversight of FHLBanks as it relates to nondepository CDFIs did not focus on membership processes due to the low risk posed, and its oversight of collateral practices did not identify areas of concern. FHFA conducts annual examinations of the FHLBanks that cover these topics, among others. According to FHFA officials, FHFA examines FHLBanks' membership approval processes to ensure that they comply with FHFA's eligibility requirements and implement a risk-management process that is intended to mitigate the FHLBanks' exposure to significant risks, especially legal, credit, and operational risk.

FHFA reviewed aspects of each FHLBank's membership process periodically in 2010 through 2013.<sup>37</sup> However, according to FHFA, it did not focus on processes specific to nondepository CDFIs because nondepository CDFIs pose low safety and soundness and credit risks, in aggregate, to FHLBanks due to their low rates of membership and

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<sup>37</sup>An FHFA official stated that FHFA did not conduct a specific membership examination for one FHLBank during 2010 through 2013 but reviewed aspects of membership as part of a different examination module.

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advances. According to FHFA officials, FHFA currently reviews each nondepository CDFI's application for membership and has not objected to any nondepository CDFI application submitted by the FHLBanks. It primarily reviews applications to gather information about the FHLBanks' membership approval process.

In annual examinations of each FHLBank in 2010 through 2013, FHFA reviewed the FHLBanks' collateral and advance practices for nondepository CDFIs and did not find any safety and soundness issues. FHFA's advances and collateral examination manual calls for it to evaluate the FHLBanks' procedures for analyzing and monitoring members, including nondepository CDFIs, and their outstanding advances. The manual also advises that special attention be given to FHLBanks' collateral practices for CDFIs because nondepository CDFIs have no dedicated regulator. Furthermore, FHFA advises that FHLBanks' credit risk-management procedures be tailored to address risks unique to each member type. For example, FHLBanks should consider that nondepository CDFIs likely are covered by federal bankruptcy statutes and not by the same receivership laws as insured depository institutions.

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### Efforts to Facilitate Nondepository CDFI Participation in the FHLBank System Include Education and Outreach

FHFA and the FHLBanks have undertaken several efforts to help educate nondepository CDFIs about and promote membership in the FHLBank System. According to FHFA officials, FHFA conducted a training session and webinar on the membership rule in February 2009, followed up on questions from CDFIs about the regulations, and tracked the progress of nondepository CDFIs in gaining membership. Officials from FHFA have made themselves available for questions about and problem solving in relation to the rules. According to FHFA and FHLBank officials as well as nondepository CDFIs we interviewed, FHFA has been encouraging FHLBanks to discuss ways in which they could increase nondepository CDFI membership and access to advances in a safe and sound manner. For example, at a speech to the FHLBank boards and executive management in early 2014, FHFA encouraged all the FHLBanks to meet collectively to discuss collateral practices that might facilitate advance activity with nondepository CDFIs, and emphasized the importance of the FHLBanks' understanding of CDFI business models and funding needs. According to FHFA officials, as a result of that speech, the FHLBanks held a conference in August 2014 with the nondepository CDFI community to discuss facilitating membership and better understand the business of nondepository CDFIs. As a follow-up to the conference, FHLBank credit officers held nondepository CDFI credit review training in October 2014. Furthermore, the FHFA Director also met with nondepository CDFI officials and trade groups in July 2014.

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In addition, all FHLBanks performed their own outreach to the nondepository CDFI community. For example, all the FHLBanks met with FHFA and nondepository CDFI members and nonmembers at the August 2014 conference to better understand nondepository CDFIs. Ten of the FHLBanks we interviewed have initiated discussions with and solicited membership applications from nondepository CDFIs since the conference. Some FHLBanks made changes in response to feedback from nondepository CDFI members. As noted previously, three of the FHLBanks that had restrictive collateral eligibility requirements amended these requirements to make obtaining advances easier for nondepository CDFIs. Two FHLBanks also made changes to their capital stock purchase requirements to allow a nondepository CDFI to be able to meet the stock purchase amount. According to the FHLBank officials, FHFA has been supportive of the changes they made to better accommodate nondepository CDFI membership and access to advances. FHFA officials told us that they have continued to encourage the FHLBanks to facilitate broader nondepository CDFI membership and access to advances.

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## Agency and Third Party Comments and Our Evaluation

We provided a draft of this report to FHFA and the 12 FHLBanks for their review and comment.<sup>38</sup> FHFA and four FHLBanks (Chicago, Cincinnati, Indianapolis, and Topeka) provided technical comments, which we incorporated as appropriate. The other eight FHLBanks did not provide any comments.

In its comments, FHLBank-Chicago also stated that our report unfairly compares nondepository CDFIs with depository institutions and that a better comparison would be regulated institutions versus nonregulated or less regulated institutions (because claims would be handled similarly for regulated institutions). Specifically, FHLBank-Chicago noted that an FHLBank likely would go through the federal bankruptcy process to settle claims if a nondepository CDFI with FHLBank credit outstanding failed, whereas a federal or state regulator would facilitate the process to settle claims if a regulated institution such as a bank, credit union, or insurance company with FHLBank credit outstanding failed. However, the purposes of our report explicitly include discussing how nondepository CDFIs differ from other members of the FHLBank System (in particular, depository members) and the membership and collateral requirements for these CDFIs. We understand that risks vary by type of institution and noted

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<sup>38</sup>We sent the report to the Council of Federal Home Loan Banks, which then passed it to the 12 FHLBanks.

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several differences—including in supervision and the liquidation of assets—between nondepository CDFIs and other types of FHLBank members in our report. Comparing the collateral requirements for nondepository CDFIs with those for depository institutions enabled us to determine how the FHLBanks address the different risks posed by nondepository CDFIs. Moreover, in terms of resolution treatments, there is no uniform approach to settling claims even within the category of “regulated institutions.” For instance, FHFA stated in one of its advisory bulletins that “FHLBanks face risks lending to insurance companies that differ in certain respects with lending to federally-insured depository institutions” and noted that “laws dealing with a failed insured depository institution are well known and uniform across the country, whereas, the laws dealing with the failure of an insurance company are less well known to the FHLBanks and, though similar, may vary somewhat from state to state.”<sup>39</sup> Therefore, we maintain that our comparisons were fair and made no change to the report in response to this comment.

In another comment, FHLBank-Chicago stated that the report implies that by loosening collateral requirements (some of which are dictated by law or regulation), more nondepository CDFIs would be eligible or willing to become FHLBank members. It noted that this was not necessarily the case, as a majority of nondepository CDFIs would not qualify for membership because of their lines of business (small business lending, microlending, and commercial lending) and because they have encumbered assets. We believe that these points are already adequately addressed in our report. Specifically, in the report we note that the types of eligible collateral are dictated by regulation. In addition, we state in the report that FHFA officials told us that some nondepository CDFIs may not be good candidates for FHLBank membership because the majority of nondepository CDFIs make nonhousing loans such as microloans, small business loans, and commercial loans. Furthermore, we note that several FHLBanks and nondepository CDFIs we interviewed told us that the requirement to pledge unencumbered assets was a challenge for nondepository CDFIs. We undertook these interviews to help understand the level of demand for FHLBank membership and obtain views on any challenges associated with obtaining membership and advances. Therefore, we made no change to the report in response to this comment.

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<sup>39</sup>FHFA, *Collateralization of Advances and Other Credit Products to Insurance Company Members*, Advisory Bulletin 2013-09 (Washington, D.C.: Dec. 23, 2013).

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In its comments, FHLBank-Indianapolis stated that the report could do a better job of making it clear that (1) FHLBanks accept assets as collateral and develop haircut methodologies to comply with regulations and an expectation of no losses in the event of default and (2) pledging illiquid assets can increase the haircut. In response, we added language in the body of the report that reiterated language in our background section stating that FHLBanks are required by statute and FHFA regulations to develop and implement collateral standards and other policies to mitigate the risk of default on outstanding advances. We also added language to the report noting that the illiquidity of assets can affect haircuts.

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As agreed with your offices, unless you publicly announce the contents of this report earlier, we plan no further distribution until 30 days from the report date. At that time, we will send copies to the appropriate congressional committees and members, the Director of FHFA, the Council of the FHLBanks, and the 12 FHLBanks. This report will also be available at no charge on our website at <http://www.gao.gov>.

Should you or your staff have questions concerning this report, please contact me at (202) 512-8678 or [garciadiazd@gao.gov](mailto:garciadiazd@gao.gov). Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. Key contributors to this report are listed in appendix IV.



Daniel Garcia-Diaz  
Director, Financial Markets and  
Community Investment



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# Appendix I: Objective, Scope, and Methodology

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The objectives of this report were to discuss (1) how nondepository community development financial institutions (CDFI) differ from other members of the Federal Home Loan Bank (FHLBank) System, in particular depository members; (2) the membership and collateral requirements for nondepository CDFIs and challenges posed by these requirements; and (3) Federal Housing Finance Agency (FHFA) oversight of FHLBanks in relation to nondepository CDFIs and efforts by FHFA and FHLBanks to increase participation of nondepository CDFIs in the FHLBank System.

To describe differences between nondepository CDFIs and other members of the FHLBank System, we reviewed relevant sections of the Housing and Economic Recovery Act of 2008 (HERA) and FHFA's final rule on nondepository CDFI membership in the FHLBank System. In addition, we reviewed other relevant information from the FHLBanks and CDFI industry, such as reports by the Department of the Treasury's Community Development Financial Institutions Fund (CDFI Fund) and the Opportunity Finance Network. We determined that these studies were methodologically sound and reliable for our purposes. To compare the asset sizes of different types of FHLBank members (nondepository CDFIs, depository institutions, and insurance companies), we analyzed available data on their assets from FHFA's membership database as of December 31, 2014. For these institution types, we calculated the distribution of their assets (minimum assets, 25th percentile, median assets, 75th percentile, and maximum assets). To assess the reliability of these data, we reviewed information about the system, interviewed knowledgeable officials, and analyzed the data for logical consistency and completeness. We found that these data were sufficiently reliable for the purpose of comparing the asset sizes of different types of FHLBank members.

To address membership and collateral requirements, we reviewed relevant legislation and regulations, such as the Federal Home Loan Bank Act and FHFA's final rule on nondepository CDFI membership. We also reviewed documentation—such as nondepository CDFI membership applications and available FHLBank guidance on assessing nondepository CDFIs for membership—from each of the FHLBanks to determine membership requirements and identify any differences among

FHLBank policies.<sup>1</sup> Specifically, one GAO analyst reviewed each FHLBank's requirements for membership and identified differences. For example, in the three areas where FHLBanks had discretion, the analyst determined whether FHLBanks had set a minimum quantitative or qualitative threshold that an applicant needed to meet. A second analyst then verified the accuracy of this information. Nondepository CDFIs are subject to specific financial condition requirements. We requested and received financial data from the CDFI Fund but determined that the dataset did not contain relevant data needed to determine how many nondepository CDFIs could meet these financial condition requirements.

To determine the number of nondepository CDFIs that were members from calendar years 2010 through 2014, we analyzed data from FHFA's membership database as of December 31, 2014. To calculate the membership rate (the percentage of nondepository CDFIs in each district that were members), we used (1) data from FHFA's membership database on the number of members as of December 31, 2014, and (2) data from the CDFI Fund on the total number of nondepository CDFIs as of December 31, 2014. We assessed the reliability of data from both systems by reviewing any relevant documentation, interviewing knowledgeable officials, and analyzing the data for logical consistency and completeness. We determined that the data were sufficiently reliable for the purposes of assessing rates of membership for nondepository CDFIs.

To determine each FHLBank's requirements for obtaining advances and any differences among the FHLBanks, we reviewed relevant documentation such as each FHLBank's collateral guidelines and product and credit policies. Using these documents, we identified the haircut (discount) for eligible collateral types for depository and nondepository institutions and other collateral requirements, such as the term of advances and collateral pledging methods. Our review of FHLBank documents showed that FHLBanks do not describe their collateral requirements uniformly. Although we took several steps that enabled us to present comparable categories of collateral across the FHLBanks, our analysis did not account for differences in the eligibility criteria for collateral that may be accepted, such as quality of collateral. As a result,

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<sup>1</sup>We reviewed all the nondepository CDFI membership applications that had been approved as of September 2014 (the most recent available at the time of our request).

the haircuts for different FHLBanks are not comparable. First, we excluded from our analysis the following types of collateral because they were only mentioned in some FHLBanks' documents: U.S. Treasury separate trading of registered interest and principal securities, agency structured bonds, agency collateralized mortgage obligation accrual bonds, second mortgage-backed securities, student loan asset-backed securities, agricultural real estate loans, land loans, construction loans, student loans, mutual funds, and municipal or state and local securities. Second, because some FHLBanks identified specific haircuts for securities, such as those originating from the Federal Deposit Insurance Corporation, while other FHLBanks listed haircuts for a general category of agency securities, we grouped all the agency securities and provided the range of haircuts. We included in the agency securities category any securities issued or guaranteed by the U.S. government, including those originating from the Federal Deposit Insurance Corporation, National Credit Union Administration, Fannie Mae, Freddie Mac, Ginnie Mae, the Federal Home Loan Banks, and the Small Business Administration. Third, because some FHLBanks identified specific haircuts for specific government-guaranteed loan collateral while others did not, we grouped all government-guaranteed loan collateral together, including loans originating from the Farm Service Agency, Department of Agriculture, Small Business Administration, Federal Housing Administration, and Department of Veterans Affairs. Fourth, because haircuts can vary based on the quality of the collateral pledged, we provided the range of haircuts for each type of collateral accepted by each FHLBank.<sup>2</sup> While we were able to review each FHLBank's collateral policies and procedures, the confidentiality of such information limited what we could publicly disclose in our report. Specifically, because the collateral haircut policies of the FHLBanks generally are considered proprietary information, we were unable to attribute specific policies to individual FHLBanks. Where appropriate, we used randomly assigned numbers when discussing FHLBank collateral policies to prevent disclosure of FHLBank identities.

Additionally, we obtained data from each FHLBank on the amount of advances secured by each nondepository CDFI member from October 2010 to September 2014 (the most recent data available at the time of our request). We assessed the reliability of these data by obtaining

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<sup>2</sup>For example, one FHLBank specified that it accepts conventional single-family residential mortgage loans while another FHLBank accepts first lien, traditional, subprime, and nontraditional mortgage loans.

information from the six FHLBanks that provided advances to nondepository CDFIs on the system they used to store the data and the procedures in place for recording and ensuring the accuracy of the data. We also reviewed the data for logical consistency and completeness. We determined that the data were sufficiently reliable for reporting the amount of advances obtained by nondepository CDFs. We also interviewed officials from the 12 FHLBanks, 3 trade groups, 10 nondepository CDFIs that were members of the FHLBanks, and 12 nondepository CDFIs that were not members to understand the level of demand for FHLBank membership and obtain views on any challenges associated with membership processes and obtaining advances.<sup>3</sup>

To develop the purposive, nonrandom sample of 10 nondepository FHLBank member CDFIs to interview, we selected a nondepository CDFI from each of the 10 FHLBanks that had a nondepository CDFI member as of March 31, 2014 (the most recent data available when we began our work and selected members to interview). In addition to geographic diversity, we sought variation in asset size, financial institution type, and FHLBank advance status. We also selected a purposive, nonrandom sample of 12 nondepository CDFIs that were not members of the FHLBank System, one from each of the 12 FHLBank districts. We selected these 12 from a sample of nondepository CDFIs that were identified during our meetings with member CDFIs and CDFI trade groups as being interested in FHLBank membership. In addition to geographic diversity, we sought variation in asset size when selecting nonmembers to interview. We interviewed officials from all 22 nondepository CDFIs by telephone, focusing on the background of the CDFI and its experience with and opinions of the FHLBank membership and advance processes. The views expressed by the nondepository CDFIs in our sample cannot be generalized to the entire population of nondepository CDFIs.

To evaluate FHFA's oversight, we reviewed relevant laws, legislative history, and regulations (including its final rule on nondepository CDFI membership) to identify FHLBanks' authority to expand membership to nondepository CDFIs and FHFA's oversight authority. We also reviewed FHFA examination policies related to membership and collateral requirement to obtain advances. To determine if membership and

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<sup>3</sup>The three trade groups we interviewed—the Opportunity Finance Network, National Association of Affordable Housing Lenders, and Housing Partnership Network—are knowledgeable about nondepository CDFIs.

advance practices were reviewed and there were any findings, we analyzed each FHLBank's examination results for fiscal years 2010 through 2013 (the most recent examinations available at the time of our request).<sup>4</sup> We interviewed FHFA and the 12 FHLBanks to further understand examination policies and practices for membership and advances and discuss any FHFA efforts to facilitate broader nondepository CDFI participation in the FHLBank System.

We conducted this performance audit from May 2014 to April 2015, in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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<sup>4</sup>An FHFA official stated that FHFA did not conduct a membership examination for one FHLBank during 2010 through 2013 but reviewed aspects of membership as part of a different examination module.

# Appendix II: Federal Home Loan Bank Collateral Requirements for Nondepository Community Development Financial Institutions and Depository Institutions

The collateral requirements—specifically the pledge method for loan collateral and haircuts (discounts)—assessed on advances to nondepository community development financial institutions (CDFI) vary from those imposed on depository members.<sup>1</sup> For example, all Federal Home Loan Banks (FHLBanks) require nondepository CDFIs to deliver collateral (a requirement that also would be applied to higher-risk depository institutions), and in some cases, nondepository CDFIs receive higher haircuts than depository institutions.<sup>2</sup> For each FHLBank, we compare the pledge method and haircuts applied to depository institutions and nondepository CDFIs below (see table 5).

**Table 5: Requirements for Pledge Method and Haircut (Discount) by FHLBank, as of December 2014**

FHLBank	Requirements for pledge method and haircut
Atlanta	FHLBank-Atlanta assigns depository members a credit risk rating of 1-10 (lowest to highest risk). It has a separate risk rating system (101-104, lowest to highest risk) for nondepository community development financial institutions (CDFI) that is based on meeting the four financial conditions for membership. A 10 rating for 2 consecutive quarters requires the depository member to deliver collateral. In comparison, all nondepository CDFIs must deliver collateral. Only nondepository CDFIs with the rating of 101 and 102 are eligible to pledge loan collateral. For securities collateral, nondepository CDFIs receive a haircut that is higher than depository members with all credit ratings. For loan collateral, depository members with a credit score of 10 receive a higher haircut than nondepository CDFIs. In comparison to depository members with a credit score of 1-9 that deliver collateral, nondepository CDFIs receive an additional 6 percentage points in haircut. <sup>a</sup>
Boston	FHLBank-Boston places depository and nondepository CDFIs members into three categories: (1) those with a generally satisfactory financial condition; (2) those that show weakening financial trends; and (3) those with financial weaknesses that present the FHLBank with an elevated level of concern. Collateral requirements for members in the respective categories primarily vary in the degree of documentation the member must provide to the FHLBank for pledged loan collateral. Category 1 members generally may report by blanket pledge status for single-family residential mortgage loans but must list all other loans. Members in categories 2 and 3 must list all loans. In addition, members in category 3 must deliver to the FHLBank (or an approved third-party) all loan documentation required by the FHLBank. Nondepository CDFIs fall under category 3. FHLBank-Boston generally applies the same haircut to all members for eligible collateral. (The haircut for single-family residential mortgage loans starts at a higher percentage for categories 2 and 3 members than for category 1 members.)

<sup>1</sup>All FHLBanks require securities to be delivered to the FHLBank or third-party custodian; the variation in pledge method is only applicable for loan collateral.

<sup>2</sup>FHLBanks that allow insurance companies (another type of nondepository institution) to pledge mortgage loan collateral also require them to deliver those collateral. Some FHLBanks impose the same haircuts for nondepository CDFIs and insurance companies.

**Appendix II: Federal Home Loan Bank  
Collateral Requirements for Nondepository  
Community Development Financial Institutions  
and Depository Institutions**

<b>FHLBank</b>	<b>Requirements for pledge method and haircut</b>
Chicago	FHLBank-Chicago ranks its members, including nondepository CDFIs, on a 7-point scale (1, 2, 3, 4, 4-, 5, and 5-) that ranges from strong capacity to meet financial commitment (1) to material default risk present (5-). For depository members, the FHLBank may (1) increase the haircut and require listed reporting for those with a rating of 4- and (2) require delivery for those with a rating of 5 and 5-. For securities collateral, FHLBank-Chicago applies a higher haircut range for nondepository members than depository members. For loan collateral, the FHLBank generally requires nondepository members to deliver collateral and applies the same haircut range as it does for depository members.
Cincinnati	FHLBank-Cincinnati ranks its members, including nondepository CDFIs, on a scale of 1-7 (lowest to highest risk). The FHLBank assigns nondepository CDFIs a rating of 5, with higher risk ratings assigned based on judgments about the institution's financial condition. The FHLBank assigns the pledge status based on its perception of credit risk posed by the institution; all nondepository CDFIs must deliver collateral. For all members, FHLBank-Cincinnati varies its haircut range by the credit score. Due to the credit rating, the FHLBank haircut range is comparatively higher for nondepository CDFIs.
Dallas	FHLBank-Dallas ranks its members, including nondepository CDFIs, on a scale of A-E* (lowest to highest risk). Depository members assigned ratings of D, E, or E* are placed into delivery pledge status. Nondepository CDFIs are assigned a credit rating of D if they meet all requirements for membership; those that do not meet the presumptive criteria for membership are assigned a rating of E or E* with different levels of mitigating factors. <sup>b</sup> FHLBank-Dallas establishes haircuts based on the pledge method, and thus nondepository CDFIs receive the haircut applicable to those required to deliver collateral. The haircuts for depository members and nondepository CDFIs on eligible collateral are comparable.
Des Moines	FHLBank-Des Moines ranks its members, including nondepository CDFIs, on a scale of A-F (A-strong, B-good, C-acceptable, D-weak, E-troubled, EFN or EFV-insolvency vulnerable, and F-likely insolvency; officials stated that institutions with EFN or EFV and F ratings are considered stressed). Depository members assigned ratings of E must list collateral and those considered stressed must deliver collateral. In contrast, all nondepository members must deliver collateral. There is no difference between the haircut applied to depository institutions and nondepository members. For both, haircut ranges for securities collateral depends on if the institution is considered stressed and the haircut ranges for eligible mortgage loan collateral depends on the extent to which the loan portfolios meet FHLBank's underwriting requirements for those collateral.
Indianapolis	FHLBank-Indianapolis scores its depository members on a scale of 0-100 (lowest to highest level of financial stress). It does not assign ratings to nondepository CDFIs, but the FHLBank stated that it would complete a financial review of each CDFI prior to making an advance. The FHLBank allows financially sound depository members to pledge under blanket status; in comparison, nondepository members must pledge under delivery status. FHLBank-Indianapolis varies its collateral ranges by the pledge method. For securities collateral, FHLBank-Indianapolis applies the same haircut range to nondepository CDFIs and depository members. For loan collateral, nondepository CDFIs receive the haircuts applicable to members that deliver collateral, which are at the lower end of the haircut range.
New York	FHLBank-New York scores its depository members on a scale of 1-9 (lowest to highest). It does not assign ratings to nondepository CDFIs, but does assess the financial conditions of the members. The FHLBank may increase the haircut or require delivery of collateral for depository institutions that are considered not well capitalized or with a credit rating of 6 or higher but require the delivery of collateral for all nondepository CDFIs. It categorically applies an additional 5 percent haircut on eligible collateral from nondepository CDFIs (compared with depository institutions).
Pittsburgh	FHLBank-Pittsburgh scores its members, including nondepository CDFIs, on a scale of 1-10 (lowest to highest risk). For depository members, the FHLBank may require delivery of collateral if a member has a rating of 8 or higher or impose an additional 15 percent haircut on pledged loan collateral and an additional 5 percent haircut on securities collateral for a member with a credit rating of 10. In comparison, nondepository CDFIs must be ranked 1-6 to pledge loan collateral, and all are required to deliver collateral. For securities collateral, the FHLBank applies the same haircut to depository institutions and nondepository CDFIs. For all eligible loan collateral, the FHLBank applies a higher haircut to nondepository CDFIs. The FHLBank stated that it may adjust this rate higher or lower based upon individual analysis of the loan collateral and the potential to price loans through a third party if it is able to receive accurate and detailed loan listing information.

**Appendix II: Federal Home Loan Bank  
Collateral Requirements for Nondepository  
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<b>FHLBank</b>	<b>Requirements for pledge method and haircut</b>
San Francisco	FHLBank-San Francisco assigns credit ratings of 1-10 (lowest to highest risk) to depository institutions. For depository institutions, the FHLBank varies the pledge method required and the haircut assessed based on credit rating. FHLBank-San Francisco has a separate risk rating system for nondepository CDFIs (low, moderate, and high risk), but for the purpose of the haircut, nondepository CDFIs are grouped with depository institutions that receive a credit rating of 8-10. Nondepository CDFIs therefore receive higher haircuts on loan collateral than depository institutions with credit ratings from 1-7. Additionally, all nondepository CDFIs are required to deliver collateral while delivery of collateral is required for depository members with credit rating of 8-10.
Seattle	FHLBank-Seattle assigns one of the following ratings to its members, including nondepository CDFIs, based on financial condition: acceptable, watch, serious, and critical. The FHLBank evaluates each member on a case-by-case basis and establishes collateral requirements based on the evaluation. All nondepository CDFIs are required to deliver collateral, while depository members rated as critical are required to deliver collateral. The FHLBank applies the same haircut ranges for depository institutions and nondepository CDFIs.
Topeka	FHLBank-Topeka does not assign specific credit ratings to members, but operates on a pass or fail financial performance evaluation based on a set of criteria for most types of members. If a member fails to meet those criteria, the FHLBank will conduct further financial analysis, called financial narratives, to determine if further credit action should be applied. Those actions related to advance haircut and pledge requirements may include but are not limited to applying a higher haircut and requiring the delivery of original collateral documents to the FHLBank. However, the FHLBank requires a financial narrative for nondepository CDFIs every quarter; the FHLBank also requires the delivery of collateral for all nondepository CDFIs. The FHLBank applies the same haircut ranges for depository institutions and nondepository CDFIs for eligible collateral.

Source: GAO analysis of FHLBank information. | GAO-15-352

<sup>a</sup>For FHLBank-Atlanta, the haircut for single-family residential mortgages varies based on the pledge method, credit rating, and collateral type. The haircut received by nondepository CDFIs for this type of collateral is 6 percentage points higher when compared to depository members with a rating of 1-9 that are required to deliver the collateral. When the haircut for nondepository CDFIs is compared to the haircut for depository members with ratings of 1-9 that list the collateral, the difference is greater. When compared to depository members with ratings of 10 that are required to either deliver or list the collateral, the haircut for nondepository CDFIs is lower. For commercial real estate and multifamily mortgage loans, nondepository CDFIs receive an additional 6 percentage points in haircut in comparison to depository members with credit scores of 1-9, but a lower haircut in comparison to depository members with a credit score of 10.

<sup>b</sup>As discussed previously, if a nondepository CDFI does not meet one or more of the four financial condition standards for FHLBank membership, the CDFI may offer a rebuttal, and the FHLBank would perform a separate analysis to determine if the nondepository CDFI was financially sound.



# Appendix III: Federal Home Loan Bank Advance Terms and Borrowing Limits for Nondepository Community Development Financial Institutions and Depository Institutions

Most Federal Home Loan Banks (FHLBanks) do not have advance terms and borrowing limits specific to nondepository community development financial institutions (CDFI). However, four FHLBanks (Des Moines, New York, Pittsburgh, and San Francisco) do have specific advance terms and borrowing limits. We summarize the advance terms and borrowing limits for each FHLBank below (see table 6).

**Table 6: Advance Terms and Borrowing Limits by FHLBank**

FHLBank	Advance terms and borrowing limits
Atlanta	FHLBank-Atlanta does not have advance terms or borrowing limits specific to nondepository community development financial institutions (CDFI). The credit limit for all members is up to 30 percent of a member's assets unless otherwise approved.
Boston	FHLBank-Boston does not have advance terms or borrowing limits specific to nondepository CDFIs. However, representatives from the FHLBank stated that the FHLBank may determine the term on a case-by-case basis. The credit limit for all members is 50 percent of the member's total assets unless otherwise approved.
Chicago	FHLBank-Chicago does not have advance terms or borrowing limits specific to nondepository CDFIs. The credit limit for all members is 35 percent of the member's total assets unless otherwise approved. Additionally, the outstanding advance generally may not exceed 20 times the amount of the member's holdings of the FHLBank's capital stock.
Cincinnati	FHLBank-Cincinnati does not have advance terms or borrowing limits specific to nondepository CDFIs. The credit limit for all members is 50 percent of the member's total assets unless otherwise approved.
Dallas	FHLBank-Dallas does not have advance terms or borrowing limits specific to nondepository CDFIs. The credit limit for all members is 50 percent of the member's total assets unless otherwise approved. FHLB-Dallas restricts advances for members with the lowest credit rating to 30 days.
Des Moines	FHLBank-Des Moines imposes the advance term and maximum amount of borrowing capacity available based on member credit ratings A-F (A-strong, B-good, C-acceptable, D-weak, E-troubled, ETN or EFV-insolvency vulnerable, and F-likely insolvency; institutions with the ETN or EFV and F categories are considered stressed). For depository members, borrowing capacity is 35 percent of total assets for those with ratings of A-C, 25 percent for D ratings, 20 percent for E ratings, and 10 percent or less for stressed members. The FHLBank does not impose term limits for depository members with credit ratings of A-D but imposes a 5-year advance term limit on depository members with ratings of E, and 1 year or less for stressed members. For nondepository members, borrowing capacity is 30 percent of total assets for those with ratings of A-C, 20 percent for D ratings, 10 percent for E ratings, and 5 percent or less for stressed members. Additionally, the advance term limit for nondepository members with credit ratings of A-D is 20 years, 5 years for those with credit ratings of E, and 1 year or less for stressed members.
Indianapolis	FHLBank-Indianapolis does not have advance terms or borrowing limits specific to nondepository CDFIs. The credit limit for depository members is 50 percent of the member's adjusted assets (defined as total assets less borrowing from all sources) unless otherwise approved. The credit limit for nondepository CDFIs is evaluated on a case-by-case basis dependent upon the institution's financial condition and eligible collateral. Representatives from the FHLBank-Indianapolis stated that although the FHLBank does not have a policy on limiting the type or term of an advance, it might do so based on the quality of the collateral pledged and a review of the nondepository CDFI's financial condition.

**Appendix III: Federal Home Loan Bank  
Advance Terms and Borrowing Limits for  
Nondepository Community Development  
Financial Institutions and Depository  
Institutions**

<b>FHLBank</b>	<b>Advance terms and borrowing limits</b>
New York	FHLBank-New York imposes a credit limit of 30 percent to 50 percent of the borrower's total assets for all members unless otherwise approved. The FHLBank limits the maximum advance term to 5 years for nondepository CDFIs and restricts nondepository CDFIs from borrowing advances with embedded options. <sup>a</sup> In comparison, FHLBank-New York may limit the product type, term of the advance, or both for depository institutions based on the nature of the FHLBank's concerns about the member's financial condition, which may be triggered by the capital ratio and credit rating.
Pittsburgh	FHLBank-Pittsburgh imposes a credit limit of 50 percent of a member's total eligible loan assets for depository and nondepository CDFI members. For depository members, FHLBank-Pittsburgh uses its internal credit rating to determine the actual lending amount and advance term (1-10; lowest to highest risk). For depository institutions, those with ratings of 1-7 receive an unlimited term; a rating of 8 limits the term to 1 year or less; and a rating of 9-10 limits the term to 90 days. FHLB-Pittsburgh limits the maximum advance term to 2 years for nondepository CDFIs unless otherwise approved.
San Francisco	FHLB-San Francisco establishes financial availability for each member based on thorough underwriting of the applicant's creditworthiness. (Financial availability determines the maximum amount and maximum term for bank credit without additional review and approval by the FHLBank.) The maximum financial availability recommended for a nondepository CDFI member is no more than 150 percent of the member's net asset value; financial availability for amounts in excess of 100 percent of the member's net asset value will be limited to a maximum term of 2 years. FHLBank-San Francisco has a term limit of 7 years for its nondepository CDFI members.
Seattle	FHLB-Seattle does not have advance terms or borrowing limits specific to nondepository CDFIs. Rather, the FHLBank determines the advance term and credit limits for all members on a case-by-case basis. At the time of membership, the FHLBank completes a credit review to establish a credit line and collateral arrangement. Borrowing capacity is limited to the lesser of (1) the approved credit line (dollar amount or percentage of assets), (2) calculated borrowing capacity based on the amount of eligible collateral pledged, or (3) the maximum amount allowed based on the customer's stock investment in the FHLBank.
Topeka	FHLBank-Topeka does not have advance terms or borrowing limits specific to nondepository CDFIs unless the financial condition warrants such a limit. The credit limit for all members is 40 percent of the borrower's total assets, although exceptions may be granted up to 55 percent with approval from the FHLBank's president. The FHLBank operates on a pass or fail financial performance evaluation based on a set of criteria. The FHLBank will conduct further financial analysis to determine if further credit action should be applied if a member fails to meet those criteria. Those actions related to advance terms and borrowing limits may include but are not limited to the following: (a) restricting the terms of advances, (b) restricting the types of advances, and (c) restricting the aggregate amount of credit.

Source: GAO analysis of FHLBank information. | GAO-15-352

<sup>a</sup>An embedded option is a characteristic of an investment that gives the issuer or holder the right to alter the level and timing of the cash flows of the investment. 12 C.F.R. § 703.2.

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# Appendix IV: GAO Contact and Staff Acknowledgments

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## GAO Contact

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## Staff Acknowledgments

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# Appendix V: Accessible Data

**Data Tables for Highlights Figure and Figure 2: Rates of Nondepository CDFI Membership by FHLBank District, as of December 31, 2014**

FHLBank	Calendar Year				
	2010	2011	2012	2013	2014
Atlanta	1	1	1	1	2
Boston	0	0	0	1	4
Chicago	0	1	1	1	1
Cincinnati	1	3	4	4	4
Dallas	0	0	2	3	4
Des Moines	0	1	1	1	1
Indianapolis	0	0	0	1	2
New York	0	0	1	2	2
Pittsburgh	0	0	0	0	1
San Francisco	0	2	3	4	5
Seattle	0	0	0	0	2
Topeka	0	0	0	0	2
<b>Total</b>	<b>2</b>	<b>8</b>	<b>13</b>	<b>18</b>	<b>30</b>

FHLBank	Member CDFIs	Nonmember CDFIs	Total CDFIs	CDFI membership rate
Atlanta	2	71	73	2.74%
Boston	4	44	48	8.33%
Chicago	1	23	24	4.17%
Cincinnati	4	26	30	13.33%
Dallas	4	41	45	8.89%
Des Moines	1	47	48	2.08%
Indianapolis	2	11	13	15.38%
New York	2	61	63	3.17%
Pittsburgh	1	31	32	3.13%
San Francisco	5	63	68	7.35%
Seattle	2	51	53	3.77%
Topeka	2	23	25	8.00%
<b>Total</b>	<b>30</b>	<b>492</b>	<b>522</b>	<b>5.75%</b>

Source: GAO analysis of FHFA Membership Database and CDFI Fund data. GAO-15-352.

Note: The number of nondepository CDFI members each year is a cumulative number and represents nondepository CDFIs that had been approved for membership and purchased stock by December 31, 2014. The membership rate is calculated by dividing the number of nondepository CDFI members by the total number of nondepository CDFIs in the FHLBank district.

**Data Table for Figure 3: Total Advances Made to Nondepository CDFIs by FHLBank District, from October 2010 through September 2014**

FHLBank	Total number of advances by FHLBank	Overnight	>1 year, excluding overnight	≥ 1 year, <5 yrs	≥5 years	Open [Note A]
Atlanta	10		10			
Boston	1				1	
Chicago	2		1		1	
Cincinnati	9		8		1	
Dallas	46	2			44	
Des Moines	0					
Indianapolis	0					
New York	0					
Pittsburgh	0					
San Francisco	47	1	20	18	4	4
Seattle	0					
Topeka	0					
<b>Total</b>	<b>115</b>	<b>3</b>	<b>39</b>	<b>18</b>	<b>51</b>	<b>4</b>

Source: GAO analysis of FHFA Membership Database and FHLBank information. GAO-15-352.

<sup>a</sup>The advances with open terms originated from FHLBank-San Francisco. With an open term, the advance does not have a stated maturity date. Rather, the advance reprices each day, and interest payments are due at the end of each month. Members have the opportunity each day to pay down their open advances without a prepayment fee.

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