Federal Housing Finance Agency
Office of Inspector General

An Overview of the FHLBank System's Structure, Operations, and Challenges

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The FHLBank System, which is sometimes referred to as the "other housing GSE,"[1] receives much less attention than the Enterprises. Yet, the FHLBank System deserves notice, among other reasons, because it currently has more than $600 billion in debt outstanding that is potentially taxpayer guaranteed,[2] and in recent years, it has faced a number of challenges in terms of its safety, soundness, and housing mission achievement. Some of these challenges include:

- Several FHLBanks made investments in mortgage securities during the housing boom years – from 2005 through 2007 – that later generated billions of dollars of losses and continue to present financial challenges.
- The FHLBank System has faced plummeting member demand for advances that negatively affects the FHLBanks' financial performance. Declining advance demand has led the FHLBanks to engage in potentially risky non-housing mission activities, such as making unsecured loans to foreign banks. Advances to insurance companies have also increased, exposing new risks, such as the fact that the FDIC does not cover the obligations of insurance companies in the event of a failure.
- The Administration has made proposals to reform the FHLBank System that may inadvertently pose challenges. These proposals include limiting FHLBank advances to small- and medium-sized members and reducing their investment portfolios. Although these proposals are intended to strengthen the FHLBank System's safety and soundness and its focus on housing mission achievement, they involve substantial revisions to some FHLBanks' current business models.

In light of these challenges and the potential risk that the FHLBank System represents, this report is intended to provide an overview of the FHLBank System's structure, operations, risks, and oversight by FHFA. It also summarizes several of the key differences between the FHLBank System and the Enterprises and discusses in detail a number of the critical challenges facing the FHLBanks and FHFA.

BACKGROUND

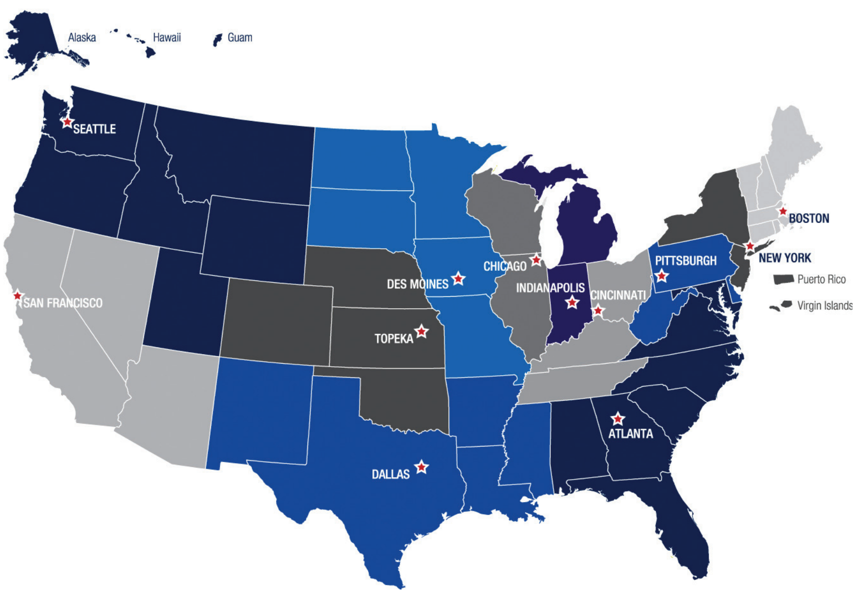
Overview of the FHLBank System's Structure

The FHLBank System was created in 1932 to improve the availability of funds for home ownership. It is organized under the authority of the Federal Home Loan Bank Act of 1932, and its mission is to provide local lenders with readily available, low-cost funding to finance housing, jobs, and economic growth.[3] The 12 FHLBanks fulfill this mission by providing liquidity to their members through advances, resulting in an increased availability of credit for residential mortgages, community investments, and other housing and community development services.[4]

The FHLBanks are cooperatives that are owned privately and wholly by their members. Each FHLBank operates as a separate entity within a defined geographic region of the country, known as its district, with its own board of directors, management, and employees. Each member of an FHLBank must purchase and maintain capital stock as a condition of its membership. FHLBank stock is held at **par value** and is not traded. FHLBank members may receive dividends on their investment in capital stock from the earnings of their bank.[5] Figure 1 (see below) provides a map of the locations of the 12 FHLBanks.

Par Value:
The face value of a security.

Figure 1. Regional FHLBanks



Source: Federal Home Loan Bank of Boston, *Federal Home Loan Bank System* (online at www.fhlbboston.com/aboutus/thebank/06_01_04_fhlb_system.jsp) (accessed Aug. 8, 2012).

Commercial Banks:
Commercial banks are establishments primarily engaged in accepting demand and other deposits and making commercial, industrial, and consumer loans. Commercial banks provide significant services in originating, servicing, and enhancing the liquidity and quality of credit that is ultimately funded elsewhere.

Thrifts:
A financial institution that ordinarily possesses the same depository, credit, financial intermediary, and account transactional functions as a bank but that is chiefly organized and primarily operates to promote savings and home mortgage lending rather than commercial lending.

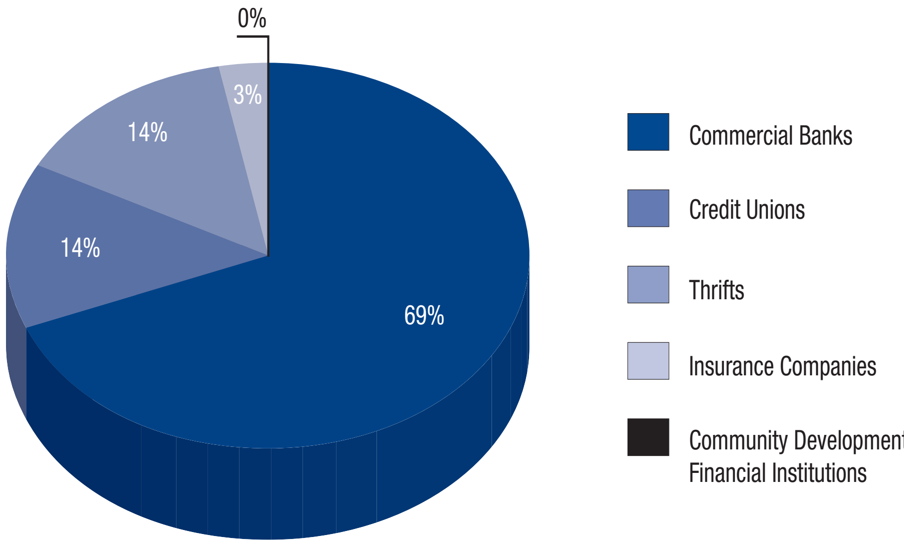
Credit Unions:
Member-owned, not-for-profit financial cooperatives that provide savings, credit, and other financial services to their members. Credit unions pool their members' savings deposits and shares to finance their own loan portfolios rather than rely on outside capital. Members benefit from higher returns on savings, lower rates on loans, and fewer fees on average.

Insurance Companies:
A company whose primary and predominant business activity is the writing of insurance and issuing or underwriting "covered products."

Community Development Financial Institutions:
A specialized financial institution that works in market niches that are underserved by traditional financial institutions. Community development financial institutions provide a unique range of financial products and services in economically distressed target markets, such as mortgage financing for low-income and first-time homebuyers and not-for-profit developers; flexible underwriting and risk capital for needed community facilities; and technical assistance, commercial loans, and investments to small start-up or expanding businesses in low-income areas. Community development financial institutions include regulated institutions such as community development banks and credit unions and non-regulated institutions such as loan and venture capital funds.

Currently, more than 7,700 financial institutions comprise the membership of the FHLBanks. These financial institutions include **banks**, **thrifts**, **credit unions**, **insurance companies**, and **community development financial institutions**.[6] Figure 2 (see below) shows the composition of the FHLBanks by member type. Commercial banks are the largest class of members at 69%. Thrifts and credit unions each comprise 14%. Insurance companies comprise 3% and community development financial institutions 0.1%.

Figure 2. 2011 FHLBank Composition by Member Type



Source: Federal Home Loan Banks, *Combined Financial Report for the Year Ended December 31, 2011*, at 30 (online at www.fhlb-of.com/ofweb_userWeb/resources/11yrend.pdf) (accessed Aug. 16, 2012).

Note: Numbers may be affected by rounding.

Each FHLBank has a board of directors that governs the bank. These boards range in size from 13 to 18 directors, as determined by FHFA. The directors are elected by member institutions and serve a four-year term.[7] Each FHLBank also has a president that reports to the board of directors of the respective FHLBank. The president's responsibilities include managing the FHLBank, administering the FHLBank's programs, and ensuring compliance with the regulations and policies of FHFA.

The compensation of FHLBank officers and employees is subject to the approval of management and the board of directors of each individual FHLBank. FHFA has established principles and guidelines for the FHLBanks and the Office of Finance in setting executive compensation policies and practices. However, each FHLBank is responsible for creating its own compensation philosophy and objectives.[8] Accordingly, compensation packages for the presidents and CEOs of the 12 FHLBanks ranged from approximately \$1.2 million to \$3.4 million for the year ended 2011.[9]

Figure 3. 2011 CEO Compensation for the Enterprises and the FHLBanks (whole dollars)

Organization	Base Salary	Bonus	Other Deferred Salary	Non-Equity Incentive Plan Compensation	Change in Pension Value and Nonqualified Deferred Compensation	Other	Total
Fannie Mae[a]	$900,000	$ -	$1,550,000	$2,808,500	$1,268,300	$11,300	$6,538,100
Freddie Mac	$900,000	$ -	$1,550,000	$1,348,500	$239,255	$72,915	$4,110,670
Cincinnati	$621,150	$ -	$ -	$512,671	$2,217,000	$25,932	$3,376,753
Indianapolis	$555,438	$ -	$ -	$504,294	$2,083,000	$14,805	$3,157,537
New York	$709,263	$ -	$ -	$523,180	$1,444,000	$120,417	$2,796,860
San Francisco	$902,967	$ -	$ -	$869,500	$732,778	$63,580	$2,568,825
Topeka	$627,500	$ -	$ -	$606,062	$1,169,289	$55,792	$2,458,643
Atlanta	$650,000	$148	$ -	$599,362	$1,089,000	$58,710	$2,397,220
Chicago	$695,000	$ -	$ -	$1,081,420	$409,000	$14,700	$2,200,120
Seattle	$391,616	$ -	$ -	$ -	$1,557,435	$181,473	$2,130,524
Dallas	$745,000	$ -	$ -	$334,557	$373,000	$600,458	$2,053,015
Des Moines	$620,833	$ -	$ -	$487,835	$441,000	$64,351	$1,614,019
Pittsburgh	$625,000	$ -	$ -	$593,156	$104,000	$40,508	$1,362,664
Boston	$595,000	$ -	$ -	$213,242	$325,000	$62,666	$1,195,908

Sources: Fannie Mae, *Form 10-K/A (Amendment No. 1) for the Fiscal Year Ended December 31, 2011*, at 9, 25 (online at www.fanniemae.com/resources/file/ir/pdf/quarterly-annual-results/2011/10ka_2011.pdf) (accessed July 26, 2012); Freddie Mac, *Form 10-K for the Fiscal Year Ended December 31, 2011*, at 335, 338, 340, 347 (online at www.freddiemac.com/investors/sec_filings/index.html) (accessed July 26, 2012); Federal Home Loan Banks, *Combined Financial Report for the Year Ended December 31, 2011*, at S-11 (online at www.fhlb-of.com/ofweb_userWeb/resources/11yrend.pdf) (accessed July 30, 2012).

Figure 3 (see above) provides information on the 2011 executive compensation for the Enterprises' CEOs and the CEOs of the 12 FHLBanks.

FHLBank System Assets, Liabilities, and Capital

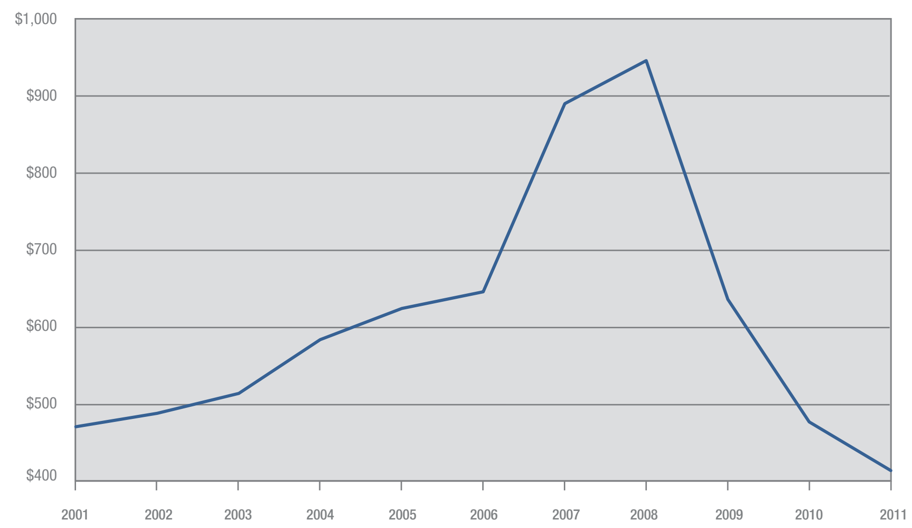
Assets

Advances are the FHLBanks' largest assets and they support members' local lending activities. In order to qualify for an advance, an FHLBank member must pledge high-quality collateral, such as government securities; mortgage loans; non-residential real estate loans; or loans for small business, agriculture, or community development. In addition, the FHLBank member must purchase additional stock in its FHLBank proportionate to the new borrowing.[10]

[a] On Mar. 9, 2012, FHFA released the report, *FHFA Announces New Conservatorship Scorecard for Fannie Mae and Freddie Mac; Reduces Executive Compensation* (Mar. 9, 2012) (online at www.fhfa.gov/webfiles/23438/ExecComp3912F.pdf). This report announced a new 2012 executive compensation program for the Enterprises, which eliminates bonuses, establishes a compensation target for new CEOs at $500,000 per year, and reduces compensation for top executives by roughly 75% since the advent of the conservatorships.

Figure 4 (see below) illustrates trends in FHLBank advances over the past 11 years. From 2005 to 2008, outstanding advances to members increased from approximately $600 billion to over $900 billion. However, as of December 2011, outstanding advances to members dropped by more than 50% to approximately $418 billion.[11] As discussed later in this report, the substantial decline in advance demand has presented considerable financial challenges to the FHLBank System.

Figure 4. FHLBank System Advances from 2001 to 2011 ($ billions)



Sources: Federal Home Loan Banks, *Combined Financial Report for the Year Ended December 31, 2011*, at 34 (online at www.fhlb-of.com/ofweb_userWeb/resources/11yrend.pdf) (accessed Aug. 8, 2012); Federal Home Loan Banks, *2006 Combined Financial Report*, at 41 (online at www.fhlb-of.com/ofweb_userWeb/resources/06yrend.pdf) (accessed Aug. 8, 2012); Federal Home Loan Banks, *2001 Unaudited Combined Financial Information*, at 5 (online at www.fhlb-of.com/ofweb_userWeb/resources/01yrend.pdf) (accessed Aug. 8, 2012).

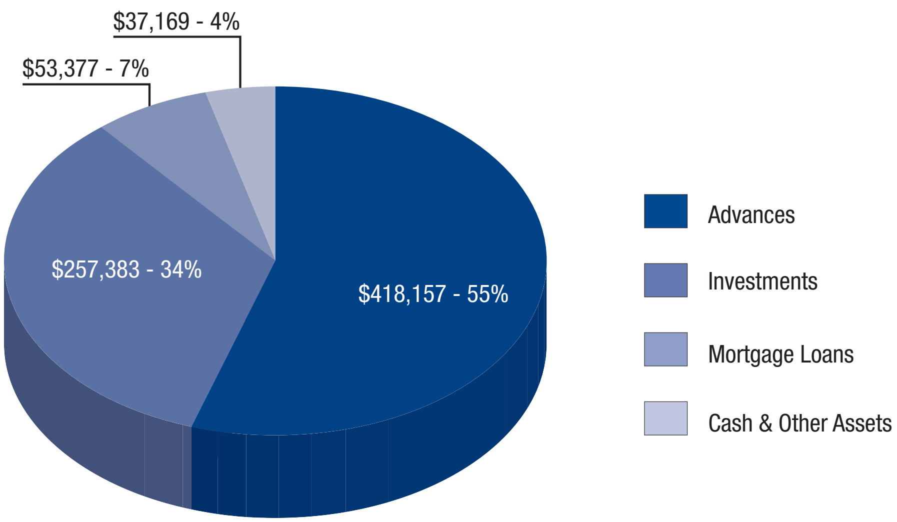
The FHLBanks also maintain investment portfolios for liquidity purposes and to generate income. These investments include **federal funds**, **certificates of deposits**, MBS, and private-label MBS. The FHLBanks' investment portfolios may also include unsecured short-term loans to domestic and foreign financial institutions. Some FHLBanks may also purchase certain whole mortgages on single-family properties directly from participating member institutions.[12]

As shown in Figure 5 (see page 7), advances represented 55% of the FHLBank System's total assets as of the end of 2011. Investments such as MBS and private-label MBS represented another 34% of total assets, and whole mortgages comprised 7%. Cash and miscellaneous assets equaled 4% of total assets.

Federal Funds:
Extensions of unsecured credit between financial institutions that are generally made on an overnight basis.

Certificate of Deposit:
A certificate of deposit is a relatively low-risk investment in a special deposit account with a bank or thrift institution. Investors commit a fixed sum of money for a fixed period of time – six months, one year, five years, or more. A certificate of deposit typically offers a higher rate of interest than a regular savings account. Interest is paid at regular intervals by the issuing bank, and when the deposit matures, the investor receives the original investment amount plus accrued interest. If the deposit is redeemed prior to the maturity date, there may be penalties associated with early withdrawal.

Figure 5. 2011 FHLBank System Consolidated Assets ($ millions)



Source: Federal Home Loan Banks, *Combined Financial Report for the Year Ended December 31, 2011*, at F-4 (online at www.fhlb-of.com/ofweb_userWeb/resources/11yrend.pdf) (accessed Aug. 7, 2012).

Liabilities

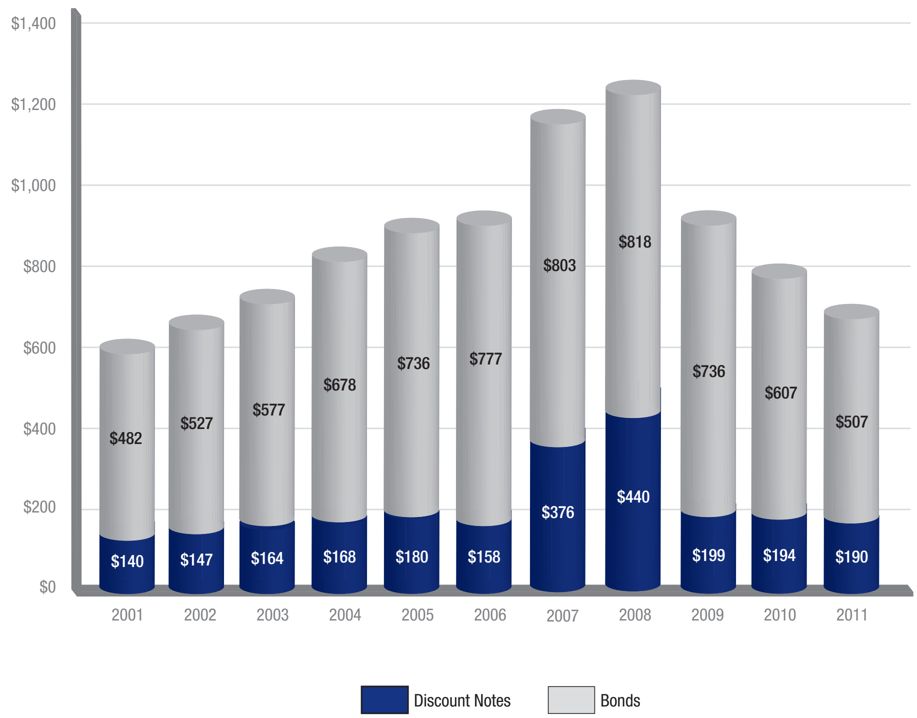
The FHLBanks fund their operations through the sale of consolidated obligations, which are **bonds** and **discount notes** issued to the public through the Office of Finance.[13] The FHLBanks issue discount notes in maturities ranging from 1 day to 1 year and bonds with maturities of 6 months to 30 years. The majority of consolidated obligation maturities are between 1 and 5 years after issuance, and the sizes of these obligations can range from $10 million to several billion dollars. The Office of Finance sells the FHLBanks' debt through a wide international network of underwriters,[14] and the FHLBanks are jointly and severally liable for their debt. Therefore, if an individual bank is unable to pay a creditor, the other 11 banks – or any 1 or more of them – are required to step in and cover the debt.[15]

Figure 6 (see page 8) shows the trends in consolidated obligations over the last 11 years. In 2007 and 2008, bond and discount note issuances peaked as FHLBank members' demand for advances soared. However, the FHLBanks' outstanding bonds and discount notes subsequently declined as demand for advances waned over the past several years.

Bonds:
Obligations by a borrower to eventually repay money obtained from a lender. The bondholder buying the investment is entitled to receive both principal and interest payments from the borrower.

Discount Notes:
Short-term obligations (debt instruments) issued at a discount from face value with maturities ranging from overnight to 360 days. Discount notes have no periodic interest payments; the investor receives the note's face value at maturity.

Figure 6. FHLBank System Consolidated Obligations from 2001 to 2011 ($ billions)



Sources: Federal Home Loan Banks, *Combined Financial Report for the Year Ended December 31, 2011*, at 34 (online at www.fhlb-of.com/ofweb_userWeb/resources/11yrend.pdf) (accessed Aug. 15, 2012); Federal Home Loan Banks, *2006 Combined Financial Report*, at 120 (online at www.fhlb-of.com/ofweb_userWeb/resources/06yrend.pdf) (accessed Aug. 15, 2012); Federal Home Loan Banks, *2004 Unaudited Combined Financial Information*, at 16 (online at www.fhlb-of.com/ofweb_userWeb/resources/04yrend.pdf) (accessed Aug. 15, 2012); Federal Home Loan Banks, *2003 Unaudited Combined Financial Information*, at 90 (online at www.fhlb-of.com/ofweb_userWeb/resources/03yrend.pdf) (accessed Aug. 15, 2012); Federal Home Loan Banks, *2001 Unaudited Combined Financial Information*, at 37 (online at www.fhlb-of.com/ofweb_userWeb/resources/01yrend.pdf) (accessed Aug. 15, 2012).

As discussed in previous OIG reports, the FHLBank System generally can issue debt at favorable interest rates compared to other financial institutions due to the implicit federal guarantee on its financial obligations.[16]

Capital

The Gramm-Leach-Bliley Act of 1999 requires each of the 12 FHLBanks to maintain sufficient capital pursuant to a capital structure plan. Each FHLBank is subject to three capital requirements under its plan: (1) total regulatory capital compliance, (2) leverage capital compliance, and (3) risk-based capital compliance.[17] These capital requirements serve as a cushion that protects against unanticipated losses and asset declines that could cause an FHLBank to fail, and FHFA reviews them to ensure the financial soundness and adequate capitalization of the FHLBanks.[18]

Figure 7 (see below) summarizes the capital standards of the FHLBank System.

Class A Stock:
Common stock issued by the FHLBanks to member institutions at a stated par value of $100 per share. Class A stock is redeemable by members at par value with six months written notice.

Class B Stock:
Common stock issued by the FHLBanks to member institutions at a stated par value of $100 per share. Class B stock is redeemable by members at par value with five years written notice.

Figure 7. FHLBank Capital Standards

	Capital Standard	Definition	Requirement
Capital Compliance[19]	• Total Regulatory Capital	• Sum of permanent capital, **Class A stock** outstanding, general loss allowance, and other amounts from sources determined by FHFA as available to absorb losses	• 4% of assets
	• Leverage Capital	• Sum of permanent capital weighted 1.5 times and all other capital without a weighting factor	• 5% of assets
	• Risk-based Capital	• Permanent capital equal to at least the sum of its credit risk, market risk, and operations risk requirements	• Permanent capital equal to at least the sum of: (1) credit risk measured by the weighted sum of asset classes, (2) market risk measured by a value-at-risk model and market value that falls below 85% of book value, and (3) operations risk equal to 30% of total credit and market risk

Housing Mission Related Programs and Activities

In addition to their traditional advance business, the FHLBanks support economic and community development through affordable housing and other programs, as summarized below.

Affordable Housing Program

The FHLBanks are required to contribute at least 10% of their net earnings to affordable housing efforts established through the Affordable Housing Program (AHP), which includes a competitive program that subsidizes the cost of owner-occupied housing for individuals and families with incomes at or below 80% of the area median income and rental housing in which at least 20% of the units are reserved for households with incomes at or below 50% of the area median income. Members submit applications on behalf of one or more sponsors of eligible housing projects. Projects must meet certain eligibility criteria and score successfully in order to obtain funding.

AHP funds are also awarded through a homeownership set-aside program, under which an FHLBank may set aside up to $4.5 million or 35% of its AHP funds each year to assist low- and moderate-income households to purchase homes. At least one-third of the FHLBank's set-aside allocation must be made available to assist first-time homebuyers. Members disburse AHP home ownership set-aside funds as grants to eligible households. Set-aside funds can be used for down payment, closing costs, counseling, or rehabilitation assistance in connection with the purchase or rehabilitation of an owner-occupied unit. Each FHLBank sets its maximum grant amount, which may not exceed $15,000 per household.[20]

To ensure that AHP projects serve local housing needs, each FHLBank is advised by a 15-member Affordable Housing Advisory Council.[21] OIG is currently conducting an evaluation of FHFA's Oversight of AHP.

Community Investment Program

Each FHLBank also operates a Community Investment Program (CIP) that offers below market rate loans to members in need of long-term financing for housing and economic development that benefits low- and moderate-income families and neighborhoods. Members use CIP to fund owner-occupied and rental housing; construct roads, bridges, retail stores, and sewage treatment plants; and provide small business loans.[22]

Economic Community Development Programs

The FHLBanks also offer long-term advances at below market interest rates through Community Investment Cash Advance (CICA) programs. CICA programs provide financing for economic development projects. CICA lending is targeted to specific beneficiaries that include small businesses and certain geographic areas.

Each FHLBank has a Community Lending Plan that describes its program objectives for economic development. Additionally, several of the FHLBanks operate other voluntary programs for affordable housing, small business lending, foreclosure prevention, and financial literacy.[23]

FHLBANK SYSTEM RISKS AND THEIR MANAGEMENT

The FHLBanks, like other financial institutions, face risks related to business operations. The following provides an overview of major risk categories and how the FHLBanks mitigate these risks. Credit risks, interest rate risks, operational risks, and housing and "image" risks are the primary risks encountered by the FHLBanks.

Credit Risks

Credit risk relates to the possibility that borrowers will fail to meet their obligations in accordance with agreed terms (e.g., that they will default on their loans).[24] The FHLBanks face credit risks to varying degrees related to their advances, unsecured credit extensions, private-label MBS, and whole mortgages, and they have a variety of options available to mitigate the risks.

Advances

The credit risk associated with advances is that a member financial institution will fail or otherwise default on an advance from an FHLBank. The potential exists that such a failure or default could result in the FHLBank incurring a loss on the advance.[25] FHFA has stated that the credit risks associated with advances, although generally viewed as low, have increased over the past few years due to the weakening financial condition of many FHLBank member institutions.[26]

The FHLBanks primarily manage the credit risks associated with advances by monitoring their members' financial health and through collateral requirements. FHLBank members are required to fully secure all advances with eligible collateral,[27] which include: (1) residential mortgage loans (the principal form of collateral),[28] (2) cash deposits held by the FHLBanks, (3) Treasury and agency securities, and (4) "other real estate related" collateral.[29] Additionally, the FHLBanks apply a percentage discount to the market value of collateral used to secure an advance; this practice is known as a "haircut."[30] An FHLBank might apply a haircut of 25% to an advance secured by investment grade securities, which means the advance would have a value equal to only 75% of the collateral. By this procedure, the FHLBanks can ensure that the value of their collateral exceeds the value of their advances and that there will be sufficient collateral available to offset any potential losses associated with a member's default on an advance.[31]

The FHLBanks use a variety of other means to mitigate the credit risks associated with advances. For example, each FHLBank establishes an

Delivery Collateral:
The most stringent collateral status used for securing advances. Under it, the FHLBanks require the member bank to deliver collateral to them or to a third-party custodian. It allows the FHLBank to have greater control of the collateral.

overall credit limit for borrowers designed to mitigate the FHLBank's credit exposure.[32] The FHLBanks may also require a troubled member to list or **deliver collateral** to a third party to ensure it is available in the event it were to fail or default on its outstanding advances.[33]

Additionally, if an FHLBank member institution fails, the FHLBanks have a first lien on the member's assets. Therefore, the banks have priority over all other creditors, including the FDIC, to obtain the collateral necessary to protect against losses on outstanding advances. Typically in a bank failure, the FDIC pays off outstanding FHLBank advances in full then takes possession of the collateral on the institution's books to help offset its losses.[34]

The featured report is available at www.fhfaoig.gov/Content/Files/AUD-2012-004.pdf.

According to FHFA, no FHLBank has ever suffered a loss on an advance.[35] However, in June 2012, OIG issued an audit assessing FHFA's oversight of the FHLBanks' advances and recommended improvements in the Agency's related oversight framework.[36]

Unsecured Loans

Unsecured loans, such as short-term loans to domestic or foreign lenders, are generally viewed as having higher credit risks than advances because they are not backed by collateral.[37] However, the short-term nature of unsecured lending helps to mitigate the credit risk. Further, the FHLBanks' unsecured loans are generally made only to highly rated private institutions (i.e., institutions rated at the "A" level or above). The FHLBanks also mitigate risks by periodically reviewing borrowers and adjusting limits on borrower exposure.[38]

The featured report is available at www.fhfaoig.gov/Content/Files/EVL-2012-005_1_0.pdf.

As discussed in Section 3 of the *Federal Housing Finance Agency Office of Inspector General Semiannual Report to the Congress, April 1, 2012, through September 30, 2012*, OIG recently issued an evaluation report that raised questions about the FHLBanks' extensions of unsecured credit primarily to European banks in 2010 and 2011. The report recommended that FHFA take steps to strengthen its oversight process and the regulatory framework for such unsecured credit extensions.[39]

Private-Label MBS

The credit risk associated with private-label MBS is that the underlying mortgages that support such securities will default and result in a loss. As discussed later in this report, several FHLBanks' investments in private-label MBS generated substantial losses in recent years.[40] To mitigate such risks, FHFA regulations place limits on the FHLBanks' overall investments in MBS to 300% of its regulatory capital. However, FHFA stated it will revisit the 300% ceiling in a future rulemaking.[41]

Whole Mortgages

As is the case with other mortgage assets, the credit risk associated with the FHLBanks' whole mortgages is that borrowers will default on such mortgages. This risk is mitigated by insurance and other credit enhancements. For example, member institutions obtain mortgage insurance for the mortgages they sell to the FHLBanks. Further, according to FHFA, the FHLBanks' mortgage holdings have fixed rates and are well seasoned, soundly underwritten, and supported by qualified borrowers.[42]

Interest Rate Risks

Interest rate risk refers to how changes in interest rates may have an adverse effect on an institution's financial condition.[43] As stated above, FHLBank operations (e.g., advances and unsecured lending) are typically funded through debt issuances (i.e., bonds or discount notes). In other words, the FHLBanks borrow at one rate and may lend at another. Thus, depending on the terms of these transactions (i.e., maturity and yield), interest rate risk can be significant.

Prepayment offers a helpful illustration of this risk. Prepayments represent risk because they can lower the FHLBanks' expected revenues from their various asset classes, while their costs of operation remain flat or increase.[44]

Advances

Prepayments of advances can lead to lower net returns if the prepayments are reinvested in assets yielding lower returns. Further, the risk can be particularly acute if an advance was financed by a higher-cost debt.[45]

Charging members a prepayment fee is one way the FHLBanks mitigate this risk. Because the FHLBanks would likely experience lower net returns due to prepayments, prepayment fees compensate for such losses, easing financial burdens. The FHLBanks also offer advances that a member may prepay without a fee. These advances are financed with instruments such as callable debt.[46] Callable debt allows an FHLBank, as the issuer, to buy back the debt when interest rates decline and prepayments are likely to increase.[47]

MBS and Whole Mortgage Loans

Mortgage-related investments such as MBS and mortgage loans are also affected by prepayments. Because single-family mortgages routinely include prepayment options, interest rate changes – particularly decreasing interest rates – often stimulate prepayments.[48]

Mitigation of interest rate risk includes FHFA regulations governing the types of MBS the FHLBanks may own. Other mitigation methods include funding mortgage-related investments with callable debt.[49]

Internal Controls:
Internal controls are an integral component of an organization's management that provide reasonable assurance that the following objectives are achieved: (1) effectiveness and efficiency of operations, (2) reliability of financial reports, and (3) compliance with applicable laws and regulations. Internal controls relate to management's plans, methods, and procedures used to meet its mission, goals, and objectives and include the processes and procedures for planning, organizing, directing, and controlling program operations as well as the systems for measuring, reporting, and monitoring program performance.

Operational Risks

Operational risks occur due to potential losses from systems and people. According to *FHFA's Oversight of Troubled Federal Home Loan Banks*, operational risks can include poor collateral risk management, flaws in the institution's information technology systems, and weak corporate governance.[50]

The FHLBanks rely on business and financial models to manage financial risks and assist in making business decisions. Each FHLBank uses different models and assumptions to determine fair values of assets, liabilities, and derivatives. Models use assumptions to project future trends and performance, and any changes in the models' underlying assumptions can cause the results to be materially different. Therefore, the reliability of an FHLBank's models is key to making good business decisions and, thus, represents operational risk.[51]

The FHLBanks' significant reliance on information systems could have severe effects on their ability to effectively conduct business if an interruption or failure occurs. In addition, failures in their financial reporting controls and procedures could adversely affect the accuracy of information reported in the FHLBanks' financial reports.[52]

The FHLBanks mitigate operational risk by, among other means, **internal controls** and continuity plans and resources. Internal controls are a major technique used to detect and prevent operational issues. Each FHLBank has a business continuity plan and a backup location that is regularly evaluated by examiners.[53]

Housing and "Image" Risks

The FHLBanks' core mission activities include advances; non-core mission activities include investing in unsecured credit, private-label MBS, and MBS.[54] A significant investment in these non-core areas exposes the FHLBanks to housing mission and "image" risks[55] and can impair their reputation. This risk is somewhat mitigated by a regulatory limit on investments in MBS (i.e., 300% of regulatory capital). However, no such ceiling controls unsecured lending.

FHFA'S FHLBANK SYSTEM SAFETY, SOUNDNESS, AND MISSION OVERSIGHT ACTIVITIES

To carry out its responsibilities with respect to the FHLBanks, FHFA may issue regulations, establish capital standards, and conduct on-site safety and soundness or mission-related examinations. FHFA may also take enforcement actions, such as issuing cease and desist orders, or may place an FHLBank into conservatorship or receivership if it becomes undercapitalized or critically undercapitalized.[56]

FHFA issues regulatory guidance designed to ensure sufficient liquidity and to protect against temporary disruptions in the capital markets that affect the FHLBanks' access to funding.[57] The prompt corrective action provisions under HERA allow FHFA to determine each FHLBank's capital classification on at least a quarterly basis. If an FHLBank is determined to be other than adequately capitalized, that FHLBank becomes subject to additional supervisory authority by FHFA.[58] If FHFA determines an FHLBank is unable to satisfy its repayment obligations, FHFA has the authority to liquidate or reorganize the FHLBank. The outstanding liabilities can then be allocated among the remaining FHLBanks in proportion to their participation in all consolidated obligations outstanding.[59]

FHFA's Division of FHLBank Regulation (DBR) is primarily responsible for ensuring that the FHLBanks operate in a financially safe and sound manner, remain adequately capitalized, raise funds in the capital markets, and operate in a manner consistent with their housing finance mission.[60] DBR oversees and directs all FHLBank examination activities, develops examination findings, and prepares reports of examination.[61]

DBR receives support from other FHFA offices. FHFA's Division of Examination Programs and Support is responsible for: (1) supporting FHFA examination activities, (2) developing and maintaining a consistent examination program, (3) developing examination policy, and (4) developing and providing FHLBank examiner training.[62] Additionally, OGC advises and supports FHFA on legal matters related to the functions, activities, and operations of FHFA and the GSEs. OGC also supports supervision functions, regulation writing, and enforcement actions when warranted.[63]

FHLBANKS AND THE ENTERPRISES

Although the FHLBanks and the Enterprises are both classified as housing GSEs, there are substantial differences in terms of their structure and operations. For example, each FHLBank is a cooperative with its stock held by member institutions. In contrast, the Enterprises are corporations owned by investors including Treasury. The FHLBanks' primary means of facilitating housing finance is to make advances directly to their member financial institutions. Whereas, the Enterprises facilitate liquidity in the housing finance system by purchasing mortgages directly from lenders and either holding them in their portfolios or securitizing them. Figure 8 (see page 16) illustrates these and other differences between the FHLBank System and the Enterprises.

Figure 8. Comparison of the FHLBanks and the Enterprises

	FHLBanks	The Enterprises
Structure	• Each FHLBank is privately owned by its members in a cooperative structure.[64] • Members of an FHLBank must purchase capital stock in their region's FHLBank and the stock is not publicly traded.[65] • FHLBank stock is purchased at the stated par value of $100 per share.[66] • Stock may be redeemed or repurchased at its stated par value.[67] • The Office of Finance issues debt on behalf of the FHLBanks. The FHLBanks are jointly and severally liable for their obligations.[68]	• Shareholder-owned companies that operate under congressional charter.[69] • Each Enterprise was placed into conservatorship on September 6, 2008, and each organization has received capital support under the PSPAs since September 2008.[70]
Governance	• Each FHLBank has its own board of directors, comprised of members of that FHLBank and independent (non-member) directors.[71] • By statute, two-fifths of the directors must be independent and at least two of those directors must be public interest directors with at least four years of experience in representing community or consumer interests.[72]	• The Enterprises' boards have a minimum of 9 and no more than 13 directors.[73] • As a result of conservatorship, FHFA immediately succeeded to all rights, titles, powers, and privileges of the Enterprises and of any officers and directors of the Enterprises.[74] • The board of directors no longer has the power or duty to manage, direct, or oversee the business and affairs of the Enterprises without approval from FHFA.[75]
Primary Business Operations	• The FHLBanks provide members with short- and long-term funding through advances, which may be used for mortgage lending and other purposes.[76]	• The Enterprises provide a secondary market for conventional conforming mortgage loans.[77] • The Enterprises buy mortgages from lenders and either hold these mortgages in their portfolios or package them into MBS that are sold to the public.[78] • Lenders use the cash raised by selling mortgages to the Enterprises to engage in further lending.[79] • The Enterprises' purchases help ensure a continuous, stable supply of mortgage money.[80]
Housing Mission	• The FHLBanks contribute 10% of their net income to affordable housing through AHP.[81] • The FHLBanks operate a CIP that offers below market rate loans to members in need of long-term financing for housing and economic development that benefits low- and moderate-income families and neighborhoods.[82] • The FHLBanks offer long-term advances at below market interest rates through CICA programs that target economic development activities.[83]	• HERA requires that FHFA establish for the Enterprises four single-family housing goals, one multifamily special affordable housing goal, and requirements relating to multifamily housing for very low-income families.[84] • Three of the single-family housing goals target purchase money mortgages for: (1) low-income families, (2) very low-income families, and (3) families that reside in low-income areas. The single-family housing goals also include one that targets refinancing mortgages for low-income families.[85] • The multifamily special affordable housing goal targets multifamily rental housing affordable to low-income families. The multifamily special affordable housing subgoal targets multifamily rental housing affordable to very low-income families.[86] • The Enterprises are also required to serve three underserved markets including: (1) manufactured housing, (2) affordable housing preservation, and (3) rural areas by developing loan products and flexible underwriting guidelines to facilitate a secondary market for mortgages for very low-, low-, and moderate-income families in those markets.[87]

CURRENT RISKS AND CHALLENGES FACING THE FHLBANK SYSTEM AND FHFA

The Agency, OIG, and others have identified a number of challenges facing the FHLBank System and FHFA. These include: housing boom era private-label MBS investments, declining member advances, large non-core mission asset portfolios, increasing advances to insurance companies, and significant advance concentrations. The FHLBank System is also challenged by a proposal that may involve substantial changes to the current business models of several FHLBanks. The following summarizes these challenges.

Managing Losses Associated with Housing Boom Era Private-Label MBS Investments

From 2005 through 2007, several FHLBanks made substantial investments in private-label MBS because these securities offered higher returns than other investments in their portfolios.[88] During those years, private-label MBS were highly rated by credit rating agencies.[89]

Gains and losses on private-label MBS are dependent on the level and direction of housing prices.[90] Accordingly, when the housing market collapsed, the FHLBanks suffered significant losses on these investments, and they continue to suffer losses in their investment portfolios.[91] Four of the FHLBanks, with which FHFA has had supervisory concerns, collectively lost approximately $2 billion on their private-label MBS investments in 2009 and 2010, as shown in Figure 9 (see below).

Figure 9. Four FHLBanks' Losses on Private-Label MBS Investments 2009 and 2010 ($ millions)

FHLBank	2009	2010	Total
Boston	$444	$85	$529
Pittsburgh	229	158	387
Chicago	437	163	600
Seattle	311	106	417
Total	**$1,421**	**$512**	**$1,933**

Sources: Federal Home Loan Bank of Boston, *Form 10-K for the Fiscal Year Ended December 31, 2010*, at 52 (online at www.sec.gov/Archives/edgar/data/1331463/000133146311000046/fhlbboston2010123110k.htm) (accessed Aug. 9, 2012); Federal Home Loan Bank of Pittsburgh, *Form 10-K for the Fiscal Year Ended December 31, 2010*, at 34 (online at www.sec.gov/Archives/edgar/data/1330399/000144530511000445/fhlbpit2010123110k.htm) (accessed Aug. 9, 2012); Federal Home Loan Bank of Chicago, *Form 10-K for the Fiscal Year Ended December 31, 2010*, at 30 (online at www.sec.gov/Archives/edgar/data/1331451/000133145111000053/fhlbchi2010123110k.htm) (accessed Aug. 9, 2012); Federal Home Loan Bank of Seattle, *Form 10-K for the Fiscal Year Ended December 31, 2010*, at 80 (online at www.sec.gov/Archives/edgar/data/1329701/000132970111000064/seattle1231201010k.htm) (accessed Aug. 9, 2012).

As illustrated in Figure 10 (see below), the FHLBanks experienced losses of $616 million on private-label MBS during the first six months of 2011. In contrast, through the first six months of 2012, the situation improved significantly as private-label MBS losses declined to $86 million.[92] However, as of June 30, 2012, the fair value of the FHLBanks' private-label MBS holdings hovered above $26 billion,[93] and these investments continue to be susceptible to deterioration in the housing market. Thus, the FHLBanks are at risk of further losses on their private-label MBS investments.[94]

Figure 10. Losses on Private-Label MBS Investments for the Six Months Ended June 30, 2011 and 2012 ($ millions)

FHLBank	2011	2012	Total
San Francisco	$272	$30	$302
Atlanta	89	15	104
Seattle	88	6	94
Boston	66	5	71
Chicago	43	15	58
Pittsburgh	31	10	41
Indianapolis	21	3	24
Dallas	4	-	4
Topeka	2	1	3
New York	-	1	1
Total	**$616**	**$86**	**$702**

Source: Federal Home Loan Banks, *Combined Financial Report for the Quarterly Period Ended June 30, 2012*, at F-68, F-69 (online at www.fhlb-of.com/ofweb_userWeb/resources/12Q2end.pdf) (accessed Aug. 31, 2012).

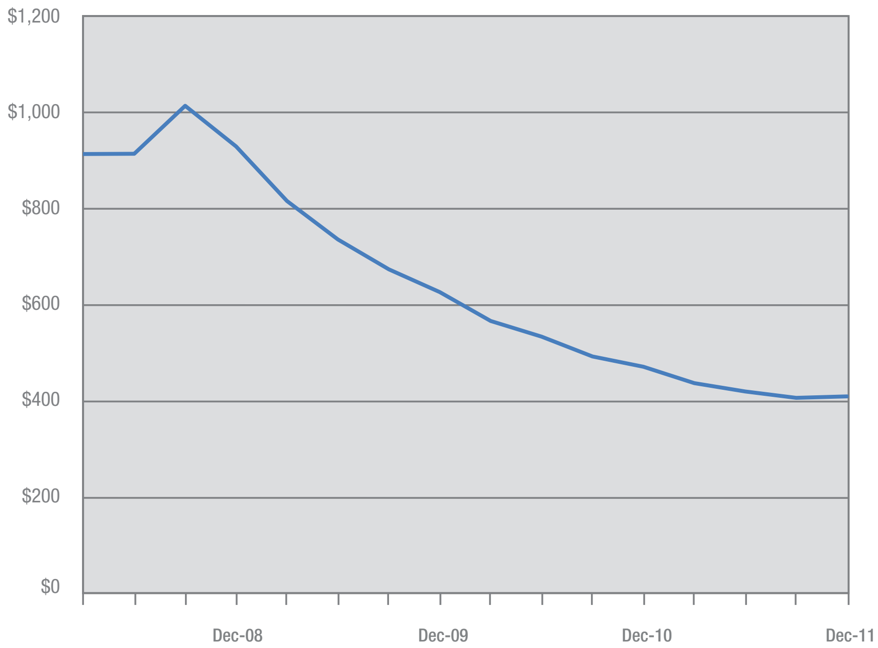
Substantially Declining Advance Demand

As illustrated in Figure 11 (see page 19), member advances have declined by more than half since 2008. The reduced demand for advances is attributed to:

- the availability of lower-cost funding options (e.g., customer deposits);
- the deterioration of the housing market beginning in 2008;
- the increase in financial institution failures;
- voluntary or forced consolidations; and
- member withdrawals.[95]

As a result of these and other factors, the FHLBanks are earning less interest income on member advances. Specifically, the FHLBanks reported interest income from advances of just over $3 billion in 2011 compared to over $29 billion in 2008.[96]

Figure 11. FHLBanks' Advances to Members 2008 Through 2011 ($ billions)



Sources: Federal Home Loan Banks, *Quarterly Combined Financial Report for the Three Months Ended March 31, 2008*, at 4 (online at www.fhlb-of.com/ofweb_userWeb/resources/08q1end.pdf) (accessed Aug. 14, 2012); Federal Home Loan Banks, *Quarterly Combined Financial Report for the Six Months Ended June 30, 2008*, at 4 (online at www.fhlb-of.com/ofweb_userWeb/resources/08q2end.pdf) (accessed Aug. 14, 2012); Federal Home Loan Banks, *Quarterly Combined Financial Report for the Nine Months Ended September 30, 2008*, at 4 (online at www.fhlb-of.com/ofweb_userWeb/resources/08q3end.pdf) (accessed Aug. 14, 2012); Federal Home Loan Banks, *2008 Combined Financial Report*, at 48 (online at www.fhlb-of.com/ofweb_userWeb/resources/08yrend.pdf) (accessed Aug. 14, 2012); Federal Home Loan Banks, *Quarterly Combined Financial Report for the Three Months Ended March 31, 2009*, at 4 (online at www.fhlb-of.com/ofweb_userWeb/resources/09q1end.pdf) (accessed Aug. 14, 2012); Federal Home Loan Banks, *Quarterly Combined Financial Report for the Six Months Ended June 30, 2009*, at 4 (online at www.fhlb-of.com/ofweb_userWeb/resources/09q2end.pdf) (accessed Aug. 14, 2012); Federal Home Loan Banks, *Quarterly Combined Financial Report for the Nine Months Ended September 30, 2009*, at 4 (online at www.fhlb-of.com/ofweb_userWeb/resources/09q3end.pdf) (accessed Aug. 14, 2012); Federal Home Loan Banks, *2009 Combined Financial Report*, at 49 (online at www.fhlb-of.com/ofweb_userWeb/resources/09yrend.pdf) (accessed Aug. 14, 2012); Federal Home Loan Banks, *Quarterly Combined Financial Report for the Three Months Ended March 31, 2010*, at 4 (online at www.fhlb-of.com/ofweb_userWeb/resources/10q1end.pdf) (accessed Aug. 14, 2012); Federal Home Loan Banks, *Quarterly Combined Financial Report for the Six Months Ended June 30, 2010*, at 4 (online at www.fhlb-of.com/ofweb_userWeb/resources/10q2end.pdf) (accessed Aug. 14, 2012); Federal Home Loan Banks, *Quarterly Combined Financial Report for the Nine Months Ended September 30, 2010*, at 4 (online at www.fhlb-of.com/ofweb_userWeb/resources/10q3end.pdf) (accessed Aug. 14, 2012); Federal Home Loan Banks, *Combined Financial Report for the Year Ended December 31, 2010*, at 36 (online at www.fhlb-of.com/ofweb_userWeb/resources/10yrend.pdf) (accessed Aug. 14, 2012); Federal Home Loan Banks, *Quarterly Combined Financial Report for the Three Months Ended March 31, 2011*, at F-2 (online at www.fhlb-of.com/ofweb_userWeb/resources/11Q1end.pdf) (accessed Aug. 14, 2012); Federal Home Loan Banks, *Combined Financial Report for the Quarterly Period Ended June 30, 2011*, at F-2 (online at www.fhlb-of.com/ofweb_userWeb/resources/11Q2end.pdf) (accessed Aug. 14, 2012); Federal Home Loan Banks, *Combined Financial Report for the Quarterly Period Ended September 30, 2011*, at F-2 (online at www.fhlb-of.com/ofweb_userWeb/resources/11Q3end.pdf) (accessed Aug. 14, 2012); Federal Home Loan Banks, *Combined Financial Report for the Year Ended December 31, 2011*, at 34 (online at www.fhlb-of.com/ofweb_userWeb/resources/11yrend.pdf) (accessed Aug. 14, 2012).

Large Non-Core Mission Investment Portfolio and Advances to Insurance Companies

Non-Core Investment Portfolio

To make up for declining advance demand, some FHLBanks made investments that involve significant risks and were not clearly consistent with their housing mission.[97] From September 2008, when advances peaked, to December 31, 2011, the proportion of advances to total assets on the FHLBanks' balance sheets decreased from 71% to 55%.[98] In contrast, during the same period of time, the proportion of investments to total assets on the FHLBanks' balance sheets increased from 23% to 34%.[99] These investments include non-core mission assets, such as unsecured credit extensions, MBS, and private-label MBS.

FHFA's Acting Director has expressed concern about the high level of non-core mission assets of certain FHLBanks. He has stated "…the FHLBanks' various financial problems of the past 20 years have not come from the traditional advance business. Instead, investments and mortgage purchase programs have been the source of deterioration in the financial condition of some FHLBanks …. [It] is not a sustainable operating condition for an FHLBank" to have a large investment portfolio.[100]

Advances to Insurance Companies

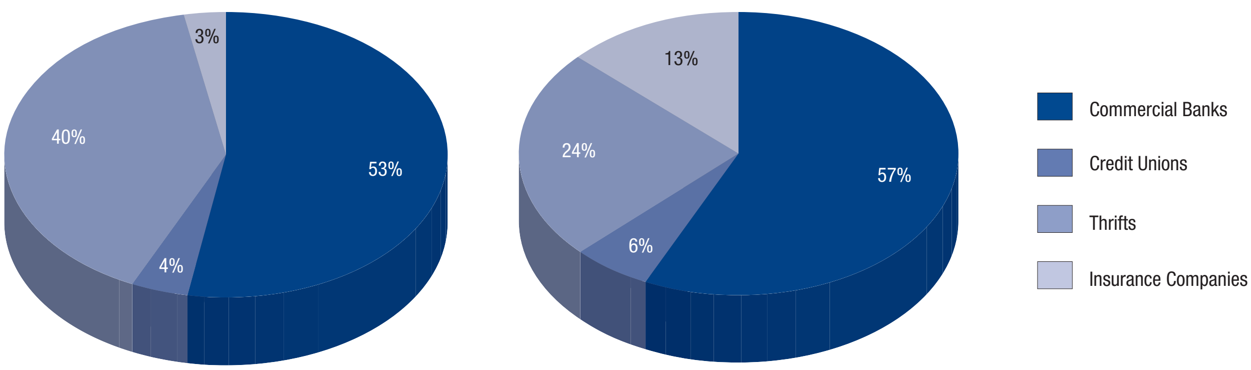
Some FHLBanks have also sought to offset their declining advances to banks and other traditional members by increasing lending to insurance companies. Specifically, advances to insurance companies have increased from 3% of total advances in 2007 to 13% of total advances in 2011, as shown in Figures 12a and 12b (see page 21).

Although FHLBank advances to insurance companies are permitted, they present risks to the FHLBank System that are distinct from risks associated with other members. For example, when a failed member bank has outstanding FHLBank advances, the FDIC generally is responsible for resolving the member's obligations. To resolve the obligations, the FDIC repays the advances in order to obtain clear title to the assets securing the advances.[101] Conversely, the FDIC does not cover the obligations of failed insurance companies.[102] Therefore, member advances to a failed insurance company will only be covered to the extent the assigned collateral is sufficient or state insurance guarantee funds make up the difference.

FHFA has recognized these risks and has prioritized them in the oversight process. OIG has an ongoing survey that is assessing the effectiveness of this oversight.

Figure 12a. 2007 FHLBank System Advances by Member Type

Figure 12b. 2011 FHLBank System Advances by Member Type

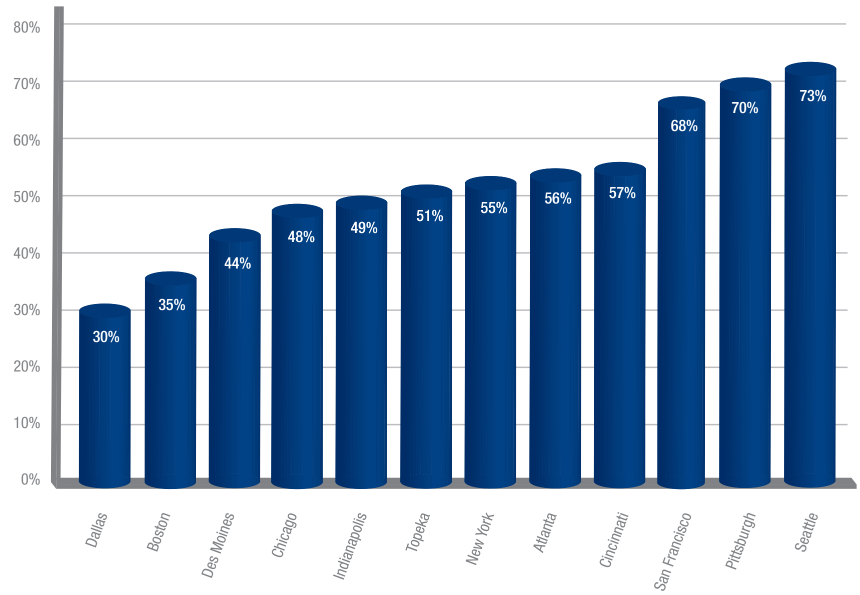


Sources: Federal Home Loan Banks, *2007 Combined Financial Report*, at 114 (online at www.fhlb-of.com/ofweb_userWeb/resources/07yrend.pdf) (accessed Aug. 20, 2012); Federal Home Loan Banks, *Combined Financial Report for the Year Ended December 31, 2011*, at 42 (online at www.fhlb-of.com/ofweb_userWeb/resources/11yrend.pdf) (accessed Aug. 20, 2012).

Advance Concentration Risk

As illustrated in Figure 13 (see page 22), several of the FHLBanks have a large percentage of their member advances confined to a relatively small percentage of members; this creates a concentration of risk. The withdrawal or failure of one or more of these members could negatively affect an FHLBank by significantly reducing its net interest income on advances. In addition, failure of one or more members could cause large losses to an FHLBank if its advances are not properly collateralized.[103]

Figure 13. 2011 FHLBanks' Advances to Their Top Five Members as a Percentage of Total Advances



Sources: Federal Home Loan Banks, *Combined Financial Report for the Year Ended December 31, 2011*, at 44, 45 (online at www.fhlb-of.com/ofweb_userWeb/resources/11yrend.pdf) (accessed Aug. 20, 2012); Federal Home Loan Bank of Seattle, *Form 10-K for the Fiscal Year Ended December 31, 2011*, at 9, 13 (online at www.sec.gov/Archives/edgar/data/1329701/000132970112000049/seattle1231201110k.htm) (accessed Oct. 18, 2012).

Proposals by the Administration That Would Significantly Alter Some FHLBanks' Current Business Models

On February 11, 2011, Treasury and HUD jointly issued a report to Congress on the future of housing finance, *Reforming America's Housing Finance Market* (the Plan), which outlines the Administration's position on reforming the U.S. housing finance market.

As with the Enterprises, the Plan proposes that the FHLBanks reduce the sizes of their investment portfolios and reorient themselves toward the core mission of providing readily available funding to FHLBank member institutions. Accordingly, the Plan advocates limiting levels of advances in order to focus FHLBank resources on small- and medium-sized financial institutions.[104]

The Plan is intended to strengthen the FHLBank System, but OIG notes that it may present substantial challenges to certain FHLBanks in the short- to medium-term. As stated earlier, many FHLBanks have significant advance concentrations with large members and, therefore, they depend on them for a significant portion of their advance revenues. Further, investment portfolios may comprise 50% or more of some FHLBanks' total assets.

Accomplishing the Plan's objectives would likely involve substantially downsizing and reorienting certain FHLBanks' current asset portfolios.[105]

FHFA has also stated that it may be necessary to merge certain FHLBanks to strengthen the FHLBank System.[106] FHFA and the FHLBanks would likely face substantial challenges in managing the transition to such a structure, and it is not clear how these changes would be accomplished.

OUTLOOK

The outlook for the FHLBank System is uncertain as reduced demand for member advances, investments in risky non-core mission activities, and other factors challenge the economic viability of the FHLBanks. The FHLBanks have a role in the future of the housing finance system, but they need to focus on their core business and improve their business models to operate in profitable and sustainable manners.[107]

Endnotes

1. Federal Reserve Bank of Atlanta, *The Federal Home Loan Bank System: The "Other" Housing GSE* (Third Quarter 2006) (online at www.frbatlanta.org/filelegacydocs/erq306_frame.pdf) (accessed Oct. 16, 2012).

2. The FHLBank System can borrow at favorable rates due to the perception in financial markets that the federal government will guarantee repayment of its debt even though such a guarantee has not been made explicitly. This phenomenon is known as the "implicit guarantee." See Federal Housing Finance Agency Office of Inspector General, *FHFA's Oversight of Troubled Federal Home Loan Banks* (Jan. 11, 2012) (EVL-2012-001) (online at www.fhfaoig.gov/Content/Files/Troubled%20Banks%20EVL-2012-001.pdf).

3. Federal Home Loan Banks, *Overview: The Federal Home Loan Banks* (online at www.fhlbanks.com/overview_whyfhlb.htm) (accessed July 24, 2012); Federal Home Loan Banks, *Combined Financial Report for the Year Ended December 31, 2011*, at 2, 3 (online at www.fhlb-of.com/ofweb_userWeb/resources/11yrend.pdf) (accessed Oct. 12, 2012).

4. Federal Home Loan Banks, *Combined Financial Report for the Year Ended December 31, 2011*, at 2 (online at www.fhlb-of.com/ofweb_userWeb/resources/11yrend.pdf) (accessed July 24, 2012).

5. *Id.* at 3, 30.

6. Federal Home Loan Banks, *The Federal Home Loan Banks: The Basics*, at 2 (online at www.fhlbanks.com/assets/pdfs/sidebar/FHLBanks_TheBasics_4_2012.pdf) (accessed July 24, 2012).

7. Federal Housing Finance Agency, *2011 Report to Congress*, at 48 (June 13, 2012) (online at www.fhfa.gov/webfiles/24009/FHFA_RepToCongr11_6_13_FINAL.pdf); Federal Home Loan Banks, *Combined Financial Report for the Year Ended December 31, 2011*, at S-1 (online at www.fhlb-of.com/ofweb_userWeb/resources/11yrend.pdf) (accessed Oct. 12, 2012).

8. Federal Home Loan Banks, *Combined Financial Report for the Year Ended December 31, 2011*, at S-6, S-10 (online at www.fhlb-of.com/ofweb_userWeb/resources/11yrend.pdf) (accessed July 24, 2012).

9. *Id*. at S-11. FHFA is authorized to review the compensation packages of FHLBank executives and to prohibit compensation that it deems unreasonable or not comparable to compensation of employees in similar businesses. See 12 U.S.C. § 4518.

10. Federal Home Loan Banks, *Frequently Asked Questions: Federal Home Loan Bank Advances* (online at www.fhlbanks.com/overview_faqs_advances.htm) (accessed July 26, 2012); Federal Home Loan Banks, *Combined Financial Report for the Year Ended December 31, 2011*, at 4 (online at www.fhlb-of.com/ofweb_userWeb/resources/11yrend.pdf) (accessed Oct. 12, 2012).

    Community development financial institutions (depository institutions insured by the FDIC with average total assets over the preceding three-year period of less than $1.076 billion) are eligible to use expanded statutory collateral provisions for small business, agriculture, and community development loans to the extent that their FHLBanks accept such loans as collateral for advances. See Federal Home Loan Banks, *Combined Financial Report for the Year Ended December 31, 2011*, at 93, F-45 (online at www.fhlb-of.com/ofweb_userWeb/resources/11yrend.pdf) (accessed Aug. 24, 2012).

11. Federal Housing Finance Agency, *2011 Report to Congress*, at 31 (June 13, 2012) (online at www.fhfa.gov/webfiles/24009/FHFA_RepToCongr11_6_14_508.pdf).

12. Federal Reserve Bank of Atlanta, *The Federal Home Loan Bank System: The "Other" Housing GSE*, at 39, 40 (Third Quarter 2006) (online at www.frbatlanta.org/filelegacydocs/erq306_frame.pdf) (accessed July 26, 2012); Federal Housing Finance Agency Office of Inspector General, *FHFA's Oversight of the Federal Home Loan Banks' Unsecured Credit Risk Management Practices*, at 8, 9, 11, 12 (June 28, 2012) (EVL-2012-005) (online at www.fhfaoig.gov/Content/Files/EVL-2012-005_1_0.pdf).

13. Federal Home Loan Banks, *Combined Financial Report for the Year Ended December 31, 2011*, at 2, 7 (online at www.fhlb-of.com/ofweb_userWeb/resources/11yrend.pdf) (accessed July 24, 2012).

14. Federal Home Loan Banks, *The Federal Home Loan Banks: The Basics*, at 3 (online at www.fhlbanks.com/assets/pdfs/sidebar/FHLBanks_TheBasics_4_2012.pdf) (accessed July 24, 2012).

15. *Id*. at 5.

16. Consequently, the FHLBanks can conceivably rely indefinitely on debt issued at favorable interest rates to engage in higher-risk financial transactions that could result in significant financial losses over time. Therefore, FHFA has a critical responsibility to conduct vigorous oversight of the FHLBanks to help ensure their safety and soundness and housing mission achievement. See Federal Housing Finance Agency Office of Inspector General, *FHFA's Oversight of Troubled Federal Home Loan Banks*, at 6 (Jan. 11, 2012) (EVL-2012-001) (online at www.fhfaoig.gov/Content/Files/Troubled%20Banks%20EVL-2012-001.pdf).

17. Federal Home Loan Banks, *Combined Financial Report for the Year Ended December 31, 2011*, at F-67 (online at www.fhlb-of.com/ofweb_userWeb/resources/11yrend.pdf) (accessed Aug. 22, 2012).

18. Federal Housing Finance Agency Office of Inspector General, *FHFA's Oversight of the Federal Home Loan Banks' Unsecured Credit Risk Management Practices*, at 15 (June 28, 2012) (EVL-2012-005) (online at www.fhfaoig.gov/Content/Files/EVL-2012-005_1_0.pdf); Federal Housing Finance Agency, *Supervision and Regulations* (online at www.fhfa.gov/Default.aspx?Page=6) (accessed Aug. 22, 2012).

19. Federal Housing Finance Agency, *Mortgage Market Note 09-3*, at 2, 3 (July 16, 2009) (online at www.fhfa.gov/webfiles/14595/MMN093FHLBcapital71609.pdf); Federal Home Loan Banks, *Combined Financial Report for the Year Ended December 31, 2011*, at F-67 (online at www.fhlb-of.com/ofweb_userWeb/resources/11yrend.pdf) (accessed Aug. 22, 2012).

20. Federal Home Loan Banks, *Combined Financial Report for the Year Ended December 31, 2011*, at 15 (online at www.fhlb-of.com/ofweb_userWeb/resources/11yrend.pdf) (accessed July 27, 2012).

21. Federal Home Loan Banks, *Frequently Asked Questions: Federal Home Loan Banks' Affordable Housing Program* (online at www.fhlbanks.com/overview_faqs_housing.htm) (accessed July 27, 2012).

22. *Id*.

23. Federal Home Loan Banks, *Combined Financial Report for the Year Ended December 31, 2011*, at 15 (online at www.fhlb-of.com/ofweb_userWeb/resources/11yrend.pdf) (accessed July 27, 2012).

24. Federal Housing Finance Agency Office of Inspector General, *FHFA's Supervisory Framework for Federal Home Loan Banks' Advances and Collateral Risk Management*, at 9 (June 1, 2012) (AUD-2012-004) (online at www.fhfaoig.gov/Content/Files/AUD-2012-004.pdf).

25. Government Accountability Office, Testimony Before the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, *Federal Home Loan Bank System: An Overview of Changes and Current Issues Affecting the System: Statement of Thomas J. McCool, Managing Director Financial Markets and Community Investment*, at 2 footnote 2 (Apr. 13, 2005) (GAO/05-489T) (online at www.gao.gov/assets/120/111492.pdf).

26. Federal Housing Finance Agency, *2011 Report to Congress*, at 32 (June 13, 2012) (online at www.fhfa.gov/webfiles/24009/FHFA_RepToCongr11_6_13_FINAL.pdf).

27. Federal Housing Finance Agency Office of Inspector General, *FHFA's Supervisory Framework for Federal Home Loan Banks' Advances and Collateral Risk Management*, at 10 (June 1, 2012) (AUD-2012-004) (online at www.fhfaoig.gov/Content/Files/AUD-2012-004.pdf).

28. Federal Home Loan Banks, *Combined Financial Report for the Year Ended December 31, 2011*, at 90 (online at www.fhlb-of.com/ofweb_userWeb/resources/11yrend.pdf) (accessed Aug. 8, 2012).

29. Federal Housing Finance Agency Office of Inspector General, *FHFA's Supervisory Framework for Federal Home Loan Banks' Advances and Collateral Risk Management*, at 10 (June 1, 2012) (AUD-2012-004) (online at www.fhfaoig.gov/Content/Files/AUD-2012-004.pdf).

30. Federal Housing Finance Agency, *2011 Report to Congress*, at 32 (June 13, 2012) (online at www.fhfa.gov/webfiles/24009/FHFA_RepToCongr11_6_13_FINAL.pdf).

31. Government Accountability Office, *Federal Housing Finance Agency: Oversight of the Federal Home Loan Banks' Agricultural and Small Business Collateral Policies Could Be Improved*, at 7 (July 2010) (GAO/10-92) (online at www.gao.gov/assets/310/307593.pdf).

32. Federal Home Loan Banks, *Combined Financial Report for the Year Ended December 31, 2011*, at 90 (online at www.fhlb-of.com/ofweb_userWeb/resources/11yrend.pdf) (accessed Aug. 8, 2012).

33. Federal Housing Finance Agency Office of Inspector General, *FHFA's Supervisory Framework for Federal Home Loan Banks' Advances and Collateral Risk Management*, at 10, 11 (June 1, 2012) (AUD-2012-004) (online at www.fhfaoig.gov/Content/Files/AUD-2012-004.pdf).

34. Government Accountability Office, *Federal Housing Finance Agency: Oversight of the Federal Home Loan Banks' Agricultural and Small Business Collateral Policies Could Be Improved*, at 8 (July 2010) (GAO/10-92) (online at www.gao.gov/assets/310/307593.pdf).

35. Federal Housing Finance Agency, *2011 Report to Congress*, at 32 (June 13, 2012) (online at www.fhfa.gov/webfiles/24009/FHFA_RepToCongr11_6_13_FINAL.pdf).

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