

Federal Housing Finance Agency
Office of Inspector General



FHFA Has Acted to Strengthen Its Oversight of Federal Home Loan Bank Members' Compliance with Community Support Requirements

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Executive Summary

The Federal Housing Finance Agency (FHFA or Agency) regulates and supervises the Federal Home Loan Bank System (FHLBank System), which consists of 11 regional FHLBanks and their fiscal agent, the Office of Finance. The FHLBanks are owned cooperatively by over 6,000 member financial institutions, including banks, thrift institutions, credit unions, and insurance companies. The FHLBanks support housing finance by providing low cost short- and long-term secured loans, known as advances, to their members. FHLBank members use advances to support their own mortgage lending, among other purposes.

FHFA sets two regulatory “community support” standards FHLBank members must meet to maintain their access to long-term advances. The first standard requires FHLBank members that are banks and thrifts to comply with ratings thresholds for the Community Reinvestment Act (CRA), which encourages lenders to meet the credit needs of the communities they serve, including low- and moderate-income neighborhoods. The second standard requires all FHLBank members to support lending to first-time homebuyers. FHFA reviews FHLBank members’ compliance with these standards every two years. As warranted, the Agency places an FHLBank member not meeting at least one of these standards on “Probation,” which does not impact that member’s access to long-term advances, or on “Restriction,” which does.

Our 2015 evaluation found that FHFA completed one of the two required biennial reviews of FHLBank member compliance with the regulatory community support requirements. Further, the completed review was finished behind schedule, and did not cover nearly 700 FHLBank members that should have been included. At the time, the biennial review process was not automated and necessitated FHFA manually reviewing the thousands of paper submissions mailed by FHLBank members to document their compliance. The Agency committed to take actions to address the deficiencies identified in our report.

We initiated this inspection to assess whether the Agency met its commitment, and found that it has taken multiple steps toward this end. For example, around 2017, FHFA replaced its manual processes with an automated system to facilitate the biennial community support reviews. FHFA states that the automated system operates reliably and described several quality control procedures that are in place to ensure the accuracy of its results, such as manual staff checks to resolve any data discrepancies. In addition, FHFA’s internal reports indicate it reviewed 99% of the more than 6,000 members subject to the 2021 biennial review by year-end 2021 and the remaining 20 members by the start of the 2023 review. FHFA placed 35 members on



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Restriction for failing to meet at least one community support standard and thereby cut off their access to long-term advances.

On the basis of FHFA's development of the automated system and the 2021 biennial review's reported results, we conclude that FHFA has taken multiple steps to address the deficiencies identified in our 2015 evaluation. We note that this inspection's scope did not encompass independently verifying FHFA's representations regarding the automated system's effectiveness or reliability, and future work to validate the system's purported quality control procedures may be appropriate.

This report was prepared by Wesley M. Phillips, Senior Policy Advisor, and Kristopher Brash Dixon, Program Analyst. We appreciate the cooperation of FHFA staff, as well as the assistance of all those who contributed to the preparation of this report.

This report has been distributed to Congress, the Office of Management and Budget, and others and will be posted on our website, www.fhfaoig.gov.

/s/

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ABBREVIATIONS

CDFI	Community Development Financial Institutions
CRA	Community Reinvestment Act
DBR	FHFA Division of Bank Regulation
DHMG	FHFA Division of Housing Mission and Goals
FHFA or Agency	Federal Housing Finance Agency
FHLBank	Federal Home Loan Bank
FHLBank System	Federal Home Loan Bank System
OIG	FHFA Office of Inspector General

BACKGROUND.....

The Federal Home Loan Bank System

FHFA regulates and supervises the FHLBank System, which consists of 11 regional FHLBanks and their fiscal agent, the Office of Finance. The FHLBanks are owned cooperatively by over 6,000 member financial institutions, including banks, thrift institutions, credit unions, and insurance companies. The FHLBank System’s mission is to support housing finance and related community investment. To do so, the Office of Finance issues debt securities, known as consolidated obligations, for all FHLBanks in the System. The FHLBanks use the debt proceeds to provide their members with short- and long-term secured loans, known as advances.¹ FHLBank members use these advances to support their own mortgage lending, among other purposes.

FHLBank Members Are Subject to Community Support Requirements

FHFA is required by statute to adopt regulations establishing standards of community investment or service that FHLBank members must meet to maintain their access to long-term advances.² Accordingly, FHFA’s community support regulation imposes two standards on nearly all FHLBank members:³

- **Community Reinvestment Act Standard:** FHLBank members that are federally insured banks and thrifts must demonstrate that they comply with the CRA. Institutions subject to the CRA are encouraged to meet the credit needs of the communities they serve, including low- and moderate-income neighborhoods. To

¹ FHLBank advances may be available to members at relatively low cost compared to other potential sources of funds. For further discussion of FHLBank advances and the requirements for a member’s use of advances, see *OIG, An Overview of the Federal Home Loan Bank System* (WPR-2023-002) (March 31, 2023).

² The regulations must take into account FHLBank members’ compliance with the CRA and their support for first-time homebuyers. 12 U.S.C. §§ 1430(g)(1)-(2).

³ Insurance companies and credit unions are not subject to the CRA. See 12 U.S.C. §§ 2901, 2902. Also, some FHLBank members are exempt from FHFA’s regulatory community support requirements, including financial institutions certified by the U.S. Department of the Treasury as Community Development Financial Institutions (CDFI). See 12 C.F.R. § 1290.2(d). Financial institutions potentially eligible for CDFI certification include banks, bank holding companies, credit unions, loan funds, and venture capital funds. A CDFI’s primary mission is to promote community development, and at least 60 percent of its financing activities must be targeted to one or more low- and moderate-income populations or underserved communities. Certified CDFIs are eligible to receive financial awards and assistance from Treasury. Institutions that have been FHLBank members for less than one year are also exempt from the community support requirements. *Id.* § 1290.2(e).

Because most FHLBank members are subject to these requirements, we use the term “FHLBank members” as shorthand for such FHLBank members.

meet the CRA standard, an institution must have received “Outstanding” or “Satisfactory” rating from its primary regulators on its most recent evaluation.⁴

- **First-time Homebuyer Standard:** FHLBank members must also demonstrate their commitment to first-time homebuyers. To do so, a member must self-certify that it meets at least one of a list of several Agency criteria related to providing mortgages to first-time homebuyers.⁵

FHFA Must Review FHLBank Members’ Compliance with the Community Support Requirements Every Two Years

FHFA’s Division of Housing Mission and Goals (DHMG) is responsible for overseeing FHLBank members’ compliance with the community support requirements. Approximately every two years, per FHFA’s regulation, FHLBank members must submit to DHMG a Community Support Statement, which: (1) provides the most recent CRA rating assigned to the FHLBank member by its primary regulator; and (2) represents that the FHLBank member has satisfied the first-time homebuyer standard by identifying the Agency criteria that it has implemented.⁶

As part of the biennial process, DHMG reviews each FHLBank member’s Community Support Statement and assigns the member one of the following three community support assessment results:

- Compliance: DHMG assigns a Compliance assessment result if the FHLBank member’s CRA rating is either “Outstanding,” or if the FHLBank member’s CRA

⁴ The Federal Deposit Insurance Corporation, the Federal Reserve Board, and the Office of the Comptroller of the Currency are the federal regulators responsible for supervising and evaluating financial institutions that have CRA obligations. The federal regulators conduct periodic reviews of these institutions to assess their compliance with community lending requirements. On the basis of these reviews, regulators may assign one of the following CRA ratings: “Substantial Noncompliance,” “Needs Improvement,” “Satisfactory,” and “Outstanding.”

⁵ The potential criteria to meet the first-time homebuyer standard include offering an in-house first-time homebuyer program; providing financial support or technical assistance to community organizations that assist first-time homebuyers; and participating in federal government programs that serve first-time homebuyers among other criteria. As noted above, members meet this requirement through self-certification; neither the FHLBank nor the Agency subsequently verify the information provided. The first-time homebuyer standard is also satisfied if the rating in the member’s most recent CRA evaluation is “Outstanding.” Whether the current system satisfactorily addresses any risk of misstatement by a member is beyond this inspection’s scope.

⁶ DHMG also tracks FHLBank members’ current and historical CRA ratings.

rating is “Satisfactory” and the FHLBank member asserts that it has satisfied at least one of the first-time homebuyer criteria.⁷

- **Probation:** DHMG places an FHLBank member on Probation if its most recent CRA rating dropped to “Needs to Improve” from a prior CRA rating of either “Outstanding” or “Satisfactory.”⁸ According to the community support regulation and DHMG officials, being placed on Probation does not affect the FHLBank member’s access to long-term advances.⁹
- **Restriction:** DHMG places an FHLBank member on Restriction for any of several reasons, including but not limited to the following: (1) the FHLBank member’s primary regulator assigns it a CRA rating of “Substantial Noncompliance,” indicating that the FHLBank member does not meet the CRA standard; or (2) the FHLBank member does not demonstrate compliance with the first-time homebuyer standard.¹⁰ FHLBank members placed on Restriction will lose access to long-term advances, which are defined by the community support regulation as having maturities of a year or more.¹¹

⁷ The Community Support Statement requires a senior official of the FHLBank member to certify that the information is accurate to the best of the official’s knowledge. The Community Support Statement also states that the failure to include this certification will result in FHFA restricting the member’s access to long-term advances. However, DHMG said it does not independently validate FHLBank members’ assertions regarding support for first-time homebuyers.

⁸ An FHLBank member will also be placed on Probation if its most recent CRA rating was “Needs to Improve” and it does not have a prior CRA rating.

⁹ An FHLBank member’s probationary period will continue until the member’s federal regulator completes its next CRA evaluation and issues a new rating for the member that is “Satisfactory” or higher. *See* 12 C.F.R. § 1290.5(c)(1).

¹⁰ In addition to the circumstances above, DHMG may also place an FHLBank member on Restriction for these additional reasons: (1) the FHLBank member’s most recent CRA rating was “Needs to Improve,” and its second-most recent CRA rating was “Needs to Improve”; (2) the FHLBank member’s most recent CRA rating was “Needs to Improve,” its second-most recent CRA rating was “Substantial Noncompliance,” and its third-most recent CRA rating was “Needs to Improve” or “Substantial Noncompliance”; (3) the FHLBank member failed to submit a Community Support Statement to FHFA, failed to sign the Community Support Statement it submitted to FHFA, or failed to include its CRA rating in the Community Support Statement it submitted to FHFA.

¹¹ Per the regulation, the FHLBank member will remain on Restriction until it demonstrates to FHFA that it has addressed the deficiency that led to the assessment result. For example, the Restriction will be removed if the FHLBank member’s next CRA rating improves to specified levels. FHFA may also remove a Restriction after a written request from the FHLBank member, if FHFA determines that the restriction may adversely affect the member’s safety and soundness. *See* 12 C.F.R. § 1290.5(d). DHMG officials said they could not recall an instance of an FHLBank member requesting to be removed from Restriction based on the latter exemption.

DHMG notifies each FHLBank of its members' community support assessment results. It is the FHLBank's responsibility to promptly notify its member of FHFA's assessment result, and for those members placed on Restriction, to terminate their access to long-term advances.

In 2015, We Found Deficiencies in DHMG's Oversight of FHLBank Members' Compliance with the Community Support Requirements

Our 2015 evaluation assessed DHMG's oversight of FHLBank members' compliance with community support requirements.¹² Such oversight included the performance of biennial reviews, which were paper-based, requiring FHLBank members to mail their Community Support Statement to the Agency for it to be processed manually. We found the following two deficiencies in this process:

- **DHMG did not meet its schedule for conducting the required community support biennial reviews of all FHLBank members.** DHMG initiated its 2010-2011 review in 2010 but did not complete that review cycle until 2013, which our report concluded was behind schedule. DHMG also did not conduct the 2012-2013 biennial review cycle at all. This allowed FHLBank members that had not complied with community support requirements to continue to have access to long-term advances. For example, we found that, in July 2012, an FHLBank member received a CRA rating of "substantial noncompliance"; based on this rating, DHMG should, and presumably would, have directed the FHLBank to restrict that member's access to long-term advances. However, FHFA did not conduct the 2012-2013 review cycle and the FHLBank member received an additional \$35 million in long-term advances.
- **DHMG did not include all FHLBank members in the 2010-2011 review cycle.** We found that the DHMG database of FHLBank members was less comprehensive than the separate database of such members maintained by FHFA's Division of Bank Regulation (DBR). This discrepancy contributed to DHMG's failure to review all members for conformance with the community support requirements. We determined that DHMG did not review more than 700 FHLBank members that were subject to the community support requirements.

In the wake of our findings, DHMG stated that it would take multiple steps to address the identified deficiencies, such as reconciling DHMG's community support database with DBR's membership database to avoid missing any FHLBank members in future biennial reviews. FHFA also stated that it would draft new policies and procedures.

¹² OIG, *FHFA's Oversight of Two Mission-Related Requirements for Federal Home Loan Bank Long-Term Advances* (ESR-2015-005) (March 31, 2015).

FACTS AND ANALYSIS

We initiated this inspection to assess whether DHMG took steps to address the identified deficiencies in its oversight of FHLBank members' compliance with the community support requirements.

DHMG Implemented an Automated System for FHLBank Members to Aid in Its Biennial Community Support Reviews

According to DHMG officials, around 2017, FHFA established an automated system to replace the paper-based processes for FHLBank members to submit their Community Support Statement for the biennial reviews.¹³ DHMG officials said that the automated system uses DBR's database of FHLBank members. This replaces the separate DHMG database, in place at the time of our 2015 report, that we found was missing FHLBank members.

DHMG officials also said that the automated system performs many of the processes that were done manually at the time of our 2015 report. For example, DHMG officials said that the automated system performs an initial review of each Community Support Statement to determine each FHLBank member's CRA rating and verify that at least one of the first-time homebuyer criteria is selected.

Further, DHMG officials said that the automated system, based on its analysis of each FHLBank member's Community Support Statement, assigns an assessment result of Compliance where appropriate, and will flag for review any Community Support Statement not meeting one of the community support standards. DHMG said it can then determine the appropriate assessment result for the FHLBank members' Community Support Statement.¹⁴ According to DHMG, only FHFA staff, and not the automated system, can place a member on Probation or Restriction for failing to meet a community support standard.

¹³ FHLBank members submit their Community Support Statement from April to October of the review year but may submit after the October 31 deadline. The 2023 review was ongoing at the time of our fieldwork.

¹⁴ We understand that DHMG does not conduct any independent quality control review of the automated system's determinations, but DHMG officials base their confidence in the system on several reported quality controls. These include but are not limited to the following: (1) DHMG works with the Agency's technology office prior to every biennial review to test and perform updates to the automated system; (2) the automated system verifies the CRA rating reported by each FHLBank member on its Community Support Statement by matching it with the CRA ratings posted on the website of the Federal Financial Institution Examination Council, which prescribes principles and standards for federal regulators' examinations of financial institutions; (3) the automated system flags approximately 1,000 to 1,200 members' Community Support Statement for follow-up manual review and confirmation by DHMG staff. The automated system's accuracy and reliability are outside of this inspection's scope, and future work to address these issues may be appropriate.

DHMG Reports Indicate that the Automated System Helped Ensure the Timely Review of All FHLBank Members During the 2021 Biennial Review

Our analysis of DHMG’s internal reports indicates that it reviewed, by year-end 2021, 6,009 of the 6,029 (99.7 percent) FHLBank members for the 2021 biennial review. DHMG reviewed the remaining 20 FHLBank members before the start of the 2023 biennial review cycle.¹⁵ DHMG’s reports indicate that its review found 99% of the 6,029 members complied with the community support requirements as shown in the table below.

FIGURE 1: OVERVIEW OF 2021 BIENNIAL REVIEW ASSESSMENT RESULTS¹⁶

	No. of Members	Percentage
Members Rated in Compliance	5,973	99.07
Members Placed on Probation	21	0.35
Members Placed on Restriction	35	0.58
Total	6,029	100.00

Upon notification by DHMG, the applicable FHLBanks duly notified the 35 members on Restricted status that they no longer had access to long-term advances until the underlying deficiencies in their Community Support Statements were resolved.¹⁷

CONCLUSIONS

DHMG has taken steps to strengthen its oversight of the community support requirements and to address the deficiencies identified in our 2015 evaluation report, including the failure to adhere to its schedule and to review all FHLBank members. This is reflected in the reported timeliness and comprehensiveness of the 2021 biennial review following DHMG’s implementation of the automated system.

¹⁵ The 20 remaining FHLBank members included members that DHMG did not review their Community Support Statement until after 2021, submitted their Community Support Statement after 2021, or had to submit additional information to DHMG.

¹⁶ DHMG provided internal reports that included details from the 2021 biennial review.

¹⁷ DHMG’s reports indicate that FHFA placed 30 of the 35 FHLBank members on Restriction because they did not submit the required information for their Community Support Statement, an additional 4 members were on Restriction because they did not meet the CRA standard, and 1 was on Restriction because it did not meet the first-time homebuyer standard. DHMG provided documentation to us indicating the FHLBanks notified the 35 members that they no longer had access to long-term advances.

OBJECTIVE, SCOPE, AND METHODOLOGY

We initiated this inspection to assess whether the Agency addressed the deficiencies identified in its oversight of the community support requirements. To accomplish our objectives, we interviewed DHMG staff and reviewed relevant federal regulations and FHFA documentation to determine what changes were implemented in the biennial review process.

We also reviewed a demonstration of DHMG’s automated system and reviewed internal DHMG reports to determine whether the 2021 biennial review occurred on schedule and included all FHLBank members. While we discussed with DHMG its processes for ensuring the reliability of the automated system’s reports, we did not independently verify those reports’ data.

We also requested documentation from DHMG that the FHLBanks notified all of their members who were placed on Restriction as a result of the 2021 biennial review.

We conducted the fieldwork for our inspection from August 2023 through September 2023 under the authority of the Inspector General Act of 1978, as amended, and in accordance with the *Quality Standards for Inspection and Evaluation* (December 2020), which were promulgated by the Council of the Inspectors General on Integrity and Efficiency.

We provided a draft of this report to FHFA for its review and comment.

ADDITIONAL INFORMATION AND COPIES.....

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