Congress of the United States
Washington, DC 20515

September 30, 2014

The Honorable Mel Watt
Director
Federal Housing Finance Agency (FHFA)
400 7th Street, SW
Washington, DC 20024

Dear Director Watt,

As members of the Washington State delegation, we write today to suggest criteria that the Federal Housing Finance Agency (FHFA) should use in evaluating any proposed mergers between Federal Home Loan Banks (FHLBs). As you know, Seattle FHLB and Des Moines FHLB have entered into a definitive merger agreement, and FHFA will soon review a merger application from the two entities, and your approval will be required in order for the merger to be consummated. In evaluating whether to give that approval, we urge you to look at not just financial factors but also whether the mission of the Federal Home Loan Banks will be served.

The regulation setting forth FHFA review of voluntary FHLB mergers is sparse, listing only financial and managerial factors to be considered by you in evaluating merger applications. This is not surprising, since it was written during a time of great financial stress on the FHLB system, but the regulation fails to address the larger housing policy reasons for which the FHLBs were created by Congress. While it is important to have strong, healthy Banks to protect taxpayers and to provide flexibility for their members, it is important to remember that this strength ultimately exists to increase access to housing in each FHLB region, and a merger ought to be measured against that principle.

For this reason, we heartily welcomed your July 31 statement on the merger discussions, where you emphasized the FHFA's focus on ensuring that each Bank "fulfills its mission by supporting home mortgage lending and community investment." In addition to the regulatory requirement to consider safety and soundness, we believe you should review three additional factors to help gauge whether the merger application furthers the purpose of these mission-driven entities.

Affordable Housing Programs

Since Congress mandated their creation and funding in 1989, the Affordable Housing Programs (AHPs) have become a critical part of fulfilling the mission for every FHLB. The AHPs make real

improvements for thousands of families in hundreds of communities each year. However, due to side effects of unrelated policies, the dollars available to each AHP vary dramatically, and this creates inequities among the FHLBs that must be worked out in any Bank merger.

Because each region's AHP is funded by 10 percent of their Bank's annual profit, AHP funds ultimately depend on the size of their Bank, and Bank size doesn't always match up well to mortgage credit activity or to housing need. Seattle's FHLB District 12 has more than twenty percent more population than Des Moines' FHLB District 8. The gap in housing spending is even wider: District 12 has over 50% more in home sales by dollar volume. And yet, because of antiquated membership rules, Des Moines FHLB has more than twice as large a balance sheet and five times as much in core mission-driven assets (member advances) as Seattle FHLB. This flows through to profits and then to AHP funding, so Seattle's AHP has fewer than half the dollars to spend in District 12 as Des Moines AHP has for District 8.

The reasons for the misalignment between population and balance sheet size are beyond the scope of a merger review, but the effect on AHP funding is something FHFA should consider carefully before approving any merger application. FHFA should ensure that disparities between two constituent Banks before a merger may not persist in the combined Bank after the merger. In administering their AHP, Seattle FHLB's Affordable Housing Advisory Council (AHAC)'s first principle is to "distribute funds equitably throughout the eight-state district." As a condition of merger, FHFA should require any merging Banks to implement a similar policy across the combined Bank's AHP to erase pre-merger disparities.

Access

FHLBs are cooperatives owned by their members and operated for the purpose of helping their members increase housing opportunity and affordability. FHLBs are especially important for smaller members who may lack other access to the capital markets. We believe that it is for this reason that the FHLBs were set up from the beginning to be regional institutions. The existence of the Seattle FHLB is a testament to that important regional role. When the Portland FHLB and Los Angeles FHLB were forcibly merged by the FHFA's predecessor, the Pacific Northwest members eventually demanded a more local, more responsive FHLB, and the current Bank was born. We urge FHFA to pay special attention to the lessons of that episode and take steps to apply that knowledge to the consideration of any future mergers.

Seattle FHLB already covers the largest FHLB district, and we believe it does it well. The Bank was moved from Spokane to Seattle many years ago in order to be closer to a major airport that can help service such a vast district, and Bank employees log thousands of miles a year travelling the region. Of course, many Bank activities can be done over the internet or the phone these days, but many, including collateral review or education and outreach, can not. FHFA should pay special attention to the challenges merged districts would present to face-to-face contact.

Des Moines and Seattle FHLBs are both known for their commitment to customer service. This history is commended, but a merger would bring immense new challenges. A combined entity would face a challenge of cutting costs while attempting to serve a district that stretches from the Mississippi River to the Marianas Islands from a headquarters city with limited air service. It would cover six time zones and be based in the easternmost one.

The FHFA has a longstanding commitment to ensuring the Banks serve all of their members equally, and not just focus on the biggest or most profitable. We believe that principle should be applied to merger consideration as well. FHFA should ask for specific plans to make sure that meetings of the Board, the AHAC and other committees are accessible to members from throughout the district, so that all states are fairly represented. FHFA should ask for specific plans to make sure all members have access throughout the member's business hours to Bank personnel with decision-making power. After approving these plans, FHFA should be prepared to enforce compliance with them in the merged Bank. In addition, if possible, FHFA should undertake a study of why the last FHLB merger failed and what can be done to better serve members in any merger going forward.

Governance

Because the Federal Home Loan Bank Act requires each bank to have a member director from each state, in addition to 40% of board seats being set aside for independent directors, the board of a combined Bank is going to be unavoidably large. This sets up a tension between representation and efficiency that a future Congress may be asked to address, but since the state directors play an important role in making sure the access issues listed above are given ongoing attention, we believe that it is best to preserve the requirement for representation from each state.

The one area where FHFA has discretion is the public interest directors. The Federal Home Loan Bank Act requires two directors on each Bank's board to serve the public interest. It is silent on what happens in a merger, but if the two merging Banks are simply combining their boards, or nearly so, it seems keeping with the spirit of the statute for the combined board to have four directors serving the public interest. We believe that FHFA should formalize that spirit in its consideration of any merger applications. These directors are charged with looking out for the Banks' public mission, and the challenges that accompany a merger make that role more important. These directors should not find their power diluted at the same time their role is most needed.

The three factors and specific suggestions listed above are all suggestions meant to test the merger applications against the FHLBs' responsibilities to serve their members and serve the public interest. They are not meant to be exhaustive or mandatory but rather suggestive of a general approach to merger review that includes a look at all of an FHLB's responsibilities. We would welcome your thoughts on how to carry out such an approach, and we look forward to hearing more on your principles for considering merger applications going forward.

Sincerely,

Denny Heck
Member of Congress

Jim McDermott
Member of Congress

Adam Smith
Member of Congress

Suzan DelBene
Member of Congress

Derek Kilmer
Member of Congress