



# Weekly Update

Public Policy Network  
FHLBank Pittsburgh

## **Policy Update March 8, 2010**

As in recent weeks in Washington's policy world, work continued behind the scenes on the development of comprehensive financial reform legislation. This growing bipartisan group of senators appears to be making progress but the future of this effort is still very much in doubt. Senate Banking Committee Chairman Chris Dodd (D-CT) said on the Senate floor late Friday, "While we do not have a bipartisan agreement yet at all, we're getting there, we're trying. I don't know if it will happen or not...It's one of the hardest tasks I've ever been asked to undertake."

What is heating up is discussion over the nature of federal support for housing finance going forward. Putting Fannie Mae and Freddie Mac on budget and providing explicit backing of future Fannie/Freddie paper (and limited backing for existing paper) is being openly discussed with immediate unsettling impact on the bond markets.

In a nutshell, uncertainty seems to be the overriding dynamic of the U.S. government in this early spring of 2010. Makes for an interesting environment to be sure.

### **Frank Statements about GSE Paper Hint at the Debate to Come**

House Financial Services Committee Chairman Barney Frank on March 5<sup>th</sup> made a number of statements about whether or not holders of Fannie/Freddie paper should expect to be backed by the Federal government if the entities default on their obligations. On Friday morning he said bondholders should expect to take a loss in the event of a default. According to Bloomberg, this caused spreads over Treasuries for Fannie/Freddie debt to widen 2 basis points minutes after Frank's comments. The Treasury Department then reiterated the 12/24/2009 statement of support to address the rapid rise in borrowing costs.

In an effort to clear up any confusion, the Chairman released a statement later in the day that supported recent Treasury statements about supporting existing Fannie/Freddie debt and also said, "In going forward, as we restructure housing finance, we will make sure that there are no implicit guarantees, hints, suggestions, or winks and nods. We will be explicit about what is and is not an obligation of the federal government." The Chairman recently reiterated his intent to include FHLBanks in this review.

We know this debate over the future of Fannie Mae and Freddie Mac will include FHLBanks and the question of federal support for FHLBank debt. The FHLBank of

Pittsburgh and the Council of FHLBanks have adopted policy in support of maintaining the current relationship of FHLBank debt to the government, to not make it an explicit federal obligation but allow it to trade as it currently does.

Meanwhile, the Republicans on the Financial Services Committee are advocating that Fannie and Freddie be placed on budget and that Fannie/Freddie debt be subject to the Federal debt ceiling.

### **Congressional Budget Office (CBO) Comments on the TARP Tax**

As reported in previous updates, the President in January proposed a 15 basis point tax on covered liabilities (assets less Tier 1 capital and insured deposits) of the nation's financial institutions with assets more than \$50 billion. In response to questions from Senate Finance Committee Ranking Member Chuck Grassley (R-IA), CBO reported that "The cost of the proposed fee would ultimately be borne to varying degrees by an institution's customers, employees, and investors." The CBO believes the impact of the fee on financial institutions would not be significant, that "the fee would probably lower the total supply of credit in the financial system to a slight degree, and would probably slightly decrease the availability of credit for small businesses."

The fee's approximate assessment on advances held by FHLBank members is almost \$500 million. Any efforts to exclude similar sources of funding from the fee, such as the repo market (as advocated by Treasury), would increase the negative impact of the tax.

Chairman Frank stated once again last week his belief the House would pass this legislation. The outlook in the Senate is less certain.

### **FHFA Publishes Notices on Community Financial Institution (CFI) Collateral**

The FHFA has proposed regulations to implement the statutory language in the Housing and Economic Recovery Act of 2008 (HERA) that expands the collateral that a CFI can pledge as collateral for advances. Last week, the FHFA adjusted the definition of a CFI to be FHLBank members below \$1.029 billion in assets. The comment period closes April 26.

The proposal offers a definition for community development which would be tied to the Community Reinvestment Act (CRA) definition, which means the collateral must be loans targeted to income levels of people and areas. This would exclude a range of economic development loans that would not fit under the CRA definition. The FHFA also excludes consumer loans or "credit extended to one or more individuals for household, family, or other personal expenditures" from the definition of a community development loan.

The FHFA believes the notice will allow for "at least marginal expansion in the types of loans that CFI members can pledge...such as (loans) that are meant to revitalize or stabilize certain designated, distressed, or underserved non-metropolitan middle-income

geographies” that would not necessarily qualify as collateral under existing advances regulations. FHFA specifically requests comments on how to alter the definitions to help CFI members fund their activities while maintaining quality collateral standards for advances.