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Statement of Shadow Financial Regulatory Committee

on

Proposed Legislation on Enterprise Resource Banks (The "Baker Bill," H.R. 3167)

May 6, 1996

Past statements of the Shadow Financial Regulatory Committee have focused on the conflict between the desire of stockholders and managers of government sponsored enterprises (GSEs) to expand their operations and the risk such operations pose to taxpayers. The current legislative proposal for a new GSE activity, in the form of the Enterprise Resource Bank Act of 1996, represents a concrete manifestation of this conflict. The legislation, like all such federal credit programs, is cast in terms of worthy objectives, but the result is likely to be a distortion of financial markets, unmeasured subsidies for some borrowers at the expense of others, hidden costs and increased risk exposure for the American taxpayer.

The Committee has spoken out several times on the risk to the taxpayer that is posed by the operations of GSEs (see Committee Statements No. 61, No. 75, and No. 131). GSEs are financial intermediaries chartered by the federal government to increase the flow of credit to designated uses, usually housing, agriculture, and education. These enterprises borrow funds in the public markets and relend to private entities. They differ from government agencies in that they are owned by private stockholders. They differ from private corporations not only in their federal origin, but also in the fact that they retain some governmental responsibilities and purportedly serve a public purpose. Importantly, the obligations of GSEs receive the benefit of an implicit federal guarantee that enhances their credit standing beyond what they would deserve strictly on the basis of their own economic strength and prospects.

The proposed Enterprise Resource Banks (ERBs) are likely to become the Godzilla of all GSEs. The ERBs are the existing Federal Home Loan Banks, but much more than a name change is involved. Federal Home Loan Banks are now oriented toward housing finance. Their loans to members must be secured by home mortgage loans. And only banks with some mortgage portfolio (10% of assets) are eligible for membership. Under the proposed legislation, only large banks would be required to meet a mortgage test in order to gain membership. Members would be able to borrow from ERBs on collateral in the form of loans to rural areas or inner cities or any loans to any small businesses. It appears that the major category of loans that would not be eligible to serve as collateral would be loans by large banks to large, suburban firms.

Part of the motivation for this legislation is to find a reason for the Federal Home Loan Banks to stay in business (see statement No. 134). Viewed as a prop for the continued existence of the FHBL System, the legislation is not needed. The FHLBs operated profitably for many years, and have incurred no credit losses in their secured lending to member institutions. However, their profitability was significantly impaired by FIRREA, which not only confiscated virtually their entire net worth, but also imposed a $300 million per year obligation to provide a debt service on bonds issued by REFCORP in 1989 as part of the resolution of the thrift crisis (see Statement No. 42). While there was reason to question the viability of the FHLB System under this obligation, FIRREA also allowed commercial banks to become members of the System. The large commercial bank membership has improved FHLB profitability. Moreover, converting the fixed $300 million REFCORP obligation to a percentage-of-earnings basis as is done by the proposed legislation would be sufficient to assure viability of the System, if there is still an economic role for it to perform.

The Shadow Financial Regulatory Committee strongly opposes the proposed legislation. The only purpose of the legislation is to create a Christmas Tree of new and unjustified subsidies that taxpayers ultimately will have to pay for.