Administrative Office
c/o Professor George Kaufman
Loyola University of Chicago
820 North Michigan Avenue
Chicago, Illinois 60611
TEL (312) 915-7075
FAX (312) 915-6118

Statement No. 134

For information contact:

George J. Benston
(404) 727-7831

Lawrence Connell
(207) 761-2638

Statement of Shadow Financial Regulatory Committee

on

A Proposal for Privatization of the Federal Home Loan Bank System

May 6, 1996

The Federal Home Loan Banks (FHLBs) were established to sell long-term obligations nationally and relend the proceeds to savings and loan associations that made and held local home mortgages. Widespread securitization of home mortgages has made the role of the FHLBs obsolete. Furthermore, thrift institutions are diversifying their portfolios away from holding mortgages and the trend of legislation appears to be to abolish the specialized thrift charter.

The FHLBs presently serve only two functions. First, with their expanded membership to commercial banks and credit unions, they function as a liquidity and asset/liability-management resource for eligible depository institutions. Although FHLB loans must be secured with mortgages, the fungible proceeds are not necessarily reinvested to finance housing, but can be invested in business and consumer loans. Second, the FHLBs support payments on REFCORP bonds, which were issued as part of the savings and loan deposit insurance fund rescue.

There is no reason to believe that a government subsidy for banks and thrifts in the form of an implicit guarantee of the FHLBs' obligations is necessary or desirable to achieve either function.

Current legislative proposals try to invent new reasons for the FHLBs' existence, casting about for new areas to extend their operations.

This is yet another example of an attempt to perpetuate a government agency after its mission has been accomplished. (See Statement No. 133.)

The Shadow Financial Regulatory Committee recommends that the Federal Home Loan Bank System should be phased out as a government sponsored enterprise. An alternative to liquidation would be privatization, which would require at least the following:

(1) Removal of the word "Federal" in its name.

(2) Removal of governmental management of the system, such as appointment of directors and oversight by the Department of Housing and Urban Development.

(3) Reincorporation under regular federal or state banking laws.

(4) Full taxation, which could be used to finance REFCORP obligations.

(5) Removal of the obligation to finance selected social programs.

A privatized Home Loan Bank System could continue to operate to the extent the market would accept the validity of its role. An example is the corporate credit union system which provides a private source of liquidity to its individual credit union customers.