THE FEDERAL HOME LOAN BANK SYSTEM: A VEHICLE FOR JOB CREATION AND JOB RETENTION

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I. *Introduction*

In September of 2010, the federal unemployment rate held steady at 9.6%, a .6% drop from the high of 10.2% of November 2009.[1] While any drop in the unemployment rate is uplifting, this decrease may be less an indication that the U.S. economy is recovering and more a reflection that many unemployed Americans have simply stopped looking for jobs. Economists estimate that the real unemployment rate may be closer to 17%.[2] Despite the $787 billion stimulus plan enacted in February of 2009, enacted "to preserve and create jobs and promote economic recovery," [3] the U.S. has shed over 8 million jobs since the recession began in 2007.[4]

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1 *The Nation's Unemployed*, WSJ.COM, http://online.wsj.com/article/SB10001424052748704852004575258351245321016.html?KEYWORDS=unemployment+rate (last visited Oct. 22, 2010); David Goldman, *The Big Jobs Hole*, CNNMONEY.COM (Feb. 5, 2010, 2:37 PM), http://money.cnn.com/2010/02/05/news/economy/jobs_january/index.htm?hpt=T1; *Economy Tracker*, CNN.COM, http://www.cnn.com/SPECIALS/map.economy/index.html?hpt=C2 (last visited Oct. 22, 2010).

2 David D. Kirkpatrick, *In a Message to Democrats, Wall St. Sends Cash to G.O.P.*, N.Y. TIMES, Feb. 8, 2010, at A1 (suggesting that the real unemployment rate is 17%).

3 American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, § 3, 123 Stat. 115, 116 (2009).

4 Goldman, *supra* note 1 (reporting that "8.4 million jobs have been vaporized since the recession began" and that businesses dropped 20,000 jobs in first month of 2010).

Productivity increases in recent months have economists fearing a jobless recovery.[5]

Despite being "huge by historical standards," the American Recovery and Reinvestment Act of 2009 has been derided as being too small[6] and too slow to stimulate job creation.[7] A public and political backlash over the stimulus' size and what many see as its ineffectiveness erupted shortly after its inception.[8]

In his January 27, 2010 State of the Union Address, President Obama vowed to focus on job creation and recovery, outlining a plan that included small business tax cuts and tax breaks as well as a $30 billion influx of Troubled Asset Relief Program ("TARP") funds to small businesses, using the country's 8,000 community banks as a conduit.[9] On September 27, 2010, Obama signed a version of this plan into law; the bill creates a $30 billion "Small Business Lending Fund" that provides capital to banks with incentives to increase their small business lending and includes several tax cuts for small business owners.[10]

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[5] *See* Harry Holzer & Robert I. Lerman, *Time for a Federal Jobs Program*, THE URBAN INSTITUTE, Nov. 23, 2009, http://www.urban.org/url.cfm?ID=901304 ("[E]mployers are thinking twice about taking on more workers since they've managed to raise productivity and output while employing fewer people.").

[6] Paul Krugman, *Of Fate and Fumbles, The Conscience of a Liberal*, NYTIMES.COM (Jan. 25, 2010, 12:30 PM), http://krugman.blogs.nytimes.com/2010/01/25/of-fate-and-fumbles/ (indicating the stimulus was "inadequate to the size of the problem").

[7] *See* Jane M. Von Bergen, *Pa., N.J. Have Millions in Stimulus Aid for Jobs*, PHILADELPHIA INQUIRER, Feb. 13, 2010, at A09 (reporting that bureaucratic problems have delayed the delivery of millions of dollars in stimulus funds meant to create jobs).

[8] Ed Hornick, *Stimulus Created Jobs, Controversy, Backlash*, CNN.COM (Feb. 17, 2010, 9:38 AM), http://www.cnn.com/2010/POLITICS/02/17/economic.stimulus.2010/index.html?hpt=Sbin.

[9] *Text: Obama's State of the Union Address*, N.Y. TIMES, Jan. 27, 2010, http://www.nytimes.com/2010/01/28/us/politics/28obama.text.html.

[10] Jeff Mason, Obama Signs Small Business Bill into Law, REUTERS (Sept. 27, 2010, 4:05 PM), http://www.reuters.com/article/2010/09/27/us-usa-economy-obama-idUSTRE68Q4H220100927; *Jesse Lee*, *President Obama Signs Small Business Jobs Act—Learn What's In It*, WHITE HOUSE BLOG (Sept. 27, 2010, 2:37 PM), http://www.whitehouse.gov/blog/2010/09/27/president-obama-signs-small-business-jobs-act-learn-whats-it ("The law sets up a lending fund for small

Small businesses, those with fewer than 500 employees, encompass more than half of U.S. private sector jobs.[11] The current recession has seen a dramatic decrease in the number and overall amount of loans made to small businesses. Many believe that lack of credit access prevents small businesses from preserving and creating new jobs.[12]

While President Obama's plan and the newly signed legislation is a good indication that the White House's attention is focused on the issue of job creation and the role small businesses can play in creating jobs, the plan has been panned by many commentators. Republicans and many bankers have balked at the use of TARP funds to stimulate job creation.[13] Critics of the plan suggest that small banks will refuse to take TARP associated monies for fear of too much federal regulation or concern over being labeled "troubled" by competitors.[14] President Obama's small business tax cuts for hiring new workers have also been criticized as "putting the cart

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businesses and includes an additional $12 billion in tax breaks for small companies.").

[11] 13 C.F.R. § 121.201 (2009) (stating that the size standard for all non-manufacturing small businesses is 500 employees, most manufacturing small businesses also use the 500 employee size standard); U.S. DEPT. OF COMMERCE, BUREAU OF THE CENSUS, STATISTICS OF U.S. BUSINESSES, TABLE 2A EMPLOYMENT SIZE OF EMPLOYER AND NONEMPLOYER FIRMS (2004), *available at* http://www.census.gov/epcd/www/smallbus.html#EmpSize.

[12] Sen. Byron Dorgan, *Small Business Credit Crunch Hampering Job Creation*, HUFFINGTON POST (Dec. 3, 2009, 6:28 PM), http://www.huffingtonpost.com/sen-byron-dorgan/small-business-credit-cru_b_379373.html.

[13] *Sen. Kent Conrad Holds a Hearing on the President's FY2011 Budget Proposal: Before the S. Committee on Budget*, 111th Cong. (2010) (statement of Sen. Gregg, Member, Sen. Comm. on Budget) ("[I]t is inexcusable that TARP is being used as a piggybank . . . . The language of TARP was very specific. Monies paid back were supposed to go to debt reduction. Once we got past the crisis, which we have by all accounts . . . we should not be drawing down more TARP money.").

[14] Ron Scherer, *Community Bankers to Obama on TARP: Thanks, But No Thanks*, CHRISTIAN SCI. MONITOR (Jan. 28, 2010), *available at* http://www.csmonitor.com/USA/2010/0128/Community-bankers-to-Obama-on-TARP-Thanks-but-no-thanks; Brian Wingfield, *Strings on the TARP*, FORBES.COM, Jan. 12, 2009, http://www.forbes.com/2009/01/11/ congress-tarp-frank-biz-beltway-cx_bw_0112frank.html ("Restrictions could deter companies from seeking . . . government assistance.").

before the horses."[15] Some small business owners claim they need money *before* they hire new workers, not after.[16]

At least one commentator has suggested using the Federal Home Loan Bank System (the "FHLB System" or the "System") to stimulate job creation.[17] The System, with its twelve regional banks and over 8,000 members has a direct channel into community banks, which are a "leading provider of credit to small businesses, a key source of job creation in this country."[18] Many of these community banks and credit unions are deeply dedicated to the communities that constitute their customer base.[19] Using the FHLB System's member banks (the "FHLBanks") to direct funds to their community bank members to promote job-enhancing small business loans avoids the problems of bureaucratic delay and inertia as well as the political backlash associated with the 2009 stimulus while also avoiding bankers' squeamishness regarding the use of TARP funds associated with President Obama's 2009 plan.[20]

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[15] Catherine Clifford, *Obama: Here's $5,000. Go hire someone*, CNNMONEY.COM (Jan. 29, 2010, 2:02 PM) http://money.cnn.com/2010/01/28/smallbusiness/obama_jobs_plan/index.htm?hpt=T2.

[16] *Id.*

[17] Tim McLaughlin, *Obama Economy Needs FHLB Boost*, BBJ BOTTOM LINE (Jan. 27, 2010, 4:28 PM) http://boston.bizjournals.com/boston/blog/bottom_line/2010/01/obamas_jobs_plan_should_include_the_fhlb.html (suggesting that the FHLB system money should be used to combat unemployment); INT'L ECON. DEV. COUNCIL, FEDERAL HOME LOAN BANKS ECONOMIC DEVELOPMENT FORUM: TARGETING ECONOMIC DEVELOPMENT, APP. A at 17 (2002) (discussing the remarks of Congressman Paul Kanjorski , "Congressman Kanjorski concluded that the FHLB System . . . should serve as the economic development arm of the government.").

[18] Ben S. Bernanke, Chairman, Fed. Reserve, Speech at the Independent Community Banker's of America's National Convention and Techworld: The Financial Crisis and Community Banking (Mar. 20, 2009) (transcript available at http://www.federalreserve.gov/newsevents/speech/Bernanke20090320a.htm).

[19] Stacy Mitchell, *The Only Way to Restore the Flow of Credit to Small Businesses*, HUFFINGTON POST (Feb. 9, 2010, 6:09 PM), http://www.huffingtonpost.com/stacy-mitchell/small-business-lending-bi_b_455839.html (stating that community banks are better able than national banks, which "rely on computer models to determine whether to make a loan," to learn about the individual borrower, her business and the local market, and thus asses risk and make successful loans to small businesses).

[20] McLaughlin, *supra* note 17.

Altering the mission of the System to emphasize job creation as well as mortgage creation comes at an opportune time for the FHLBanks. With the downturn in the economy, fewer Americans can afford to purchase homes and many Americans are experiencing home foreclosures. These changes have some questioning whether the System, with its primary goal of mortgage creation, is still a viable entity. In January of 2009, Moody's Investors Service observed that the FHLBanks "face potentially 'substantial' losses on mortgage bonds, and in a worst-case scenario only four of the 12 would remain above regulatory capital minimums."[21] While investment in mortgage securities has proven risky for the System, advances secured by mortgage loans have held up well. Adding job creation to the mission of the System could provide the FHLBanks with a more relevant objective in the modern economy—where home sales recently hit record lows and many cannot afford to purchase a home because they are out of work.[22]

This paper discusses three proposals aimed at reorienting the mission of the System and of the FHLBanks: (1) liberalizing the System's collateral requirements to make the use of small business and other job-creation loans a more viable source of collateral for advances; (2) expanding the membership requirements of the FHLBanks to allow those financial institutions that currently lend to small businesses to become members; and (3) creating a job creation program that uses some of the best practices of the System's Affordable Housing Program. Taken together or separately, these proposals utilize the unique structure of the FHLB System as described below to create and preserve jobs.

II. The Federal Home Loan Bank Act and the Federal Home Loan Bank System

The Federal Home Loan Bank Act (the "FHLB Act"), described by President Hoover in his 1931 State of the Union Address and enacted in 1932, was intended "to rescue failing savings

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[21] Jody Shen, *FHLBs May Fall Below Capital Minimums, Moody's Says*, BLOOMBERG.COM, (Jan. 8, 2009, 2;44 PM), http://www.bloomberg.com/apps/news?pid=20601087&sid=aeB5GL6uSr3A&refer=home.

[22] Javier C. Hernandez & David Streitfield, *New-Home Sales at a Low in U.S.*, N.Y. TIMES, Feb. 25, 2010, at B8 (reporting that new home sales fell 11.2% in the month of January 2010 and that mortgage applications dropped to the lowest level since May 1997).

and loan institutions ("S&Ls") by channeling cash to that industry."[23] During the Great Depression, a drastic drop in residential real estate values paired with limited refinancing opportunities caused many homeowners to default on their home mortgages.[24] The FHLB Act endeavored to "promote the use of long-term, fixed-rate, fully amortizing residential mortgages" and to prop up the mortgage-lending financial institutions that were harmed by their customers' rush to withdraw deposits.[25] Bank customers, many of whom had lost their jobs, needed the money for their personal use or were reacting in sheer panic.[26]

Representative Robert Luce of Massachusetts sponsored the FHLB Bill in the House.[27] In his statement to the subcommittee, Luce noted that the FHLB System would "expand the credit facilities in the building field" as the Federal Reserve System (created in 1913) and the federal farm loan system (created in 1916) furnish credit to the commercial and agricultural fields, respectively.[28] Luce stated that the FHLB Bill served "three general purposes:" (1) "to relieve the present emergency" for home owners and potential home owners who were unable to obtain home loans for home purchases or remodeling during the Depression, as well as for financial

[23] 2 JERRY W. MARKHAM, A FINANCIAL HISTORY OF THE UNITED STATES 163 (2002); Annual Message to the Congress on the State of the Union, 1931 PUB. PAPERS 580 [hereinafter *1931 State of the Union*] (Dec. 18, 1931).

[24] Mark J. Flannery & W. Scott Frame, *The Federal Home Loan Bank System: The "Other" Housing GSE*, FED. RESERVE BANK OF ATLANTA ECONOMIC REVIEW (2006), at 33, *available at* http://www.aei.org/docLib/20070404_FlanneryandFramePaper.pdf ("In the early 1930s residential real estate values (and financial assets generally) fell dramatically. Coupled with limited refinancing opportunities, this decline generated a wave of mortgage defaults….").

[25] *Id.* at 33.

[26] *Id.*; *Creation of a System of Federal Home Loan Banks: Hearings Before a Subcomm. of the H. Comm. on Banking and Currency*, 72nd Cong. 12 (1932) [hereinafter *Creation of a System of Federal Home Loan Banks*] (statement of Rep. Luce, House Comm. On Banking and Currency).

[27] *Creation of a System of Federal Home Loan Banks*, *supra* note 26, at 12 (statement of Rep. Luce, House Comm. On Banking and Currency).

[28] *Id. But see* Morton Bodfish, *Toward an Understanding of the Federal Home Loan Bank System*, 15 J. OF LAND & PUB. UTIL. ECON. 377, 416-17 (1939) (stating that in creating the FHLB System, the creators never intended to create a new central banking structure).

institutions to "meet applications for withdrawals, but also to enable [financial institutions] to resume business, in as much as they are practically now out of business for the time being;" (2) to anticipate and "provide against repetitions of such emergencies;" and (3) to create a permanent credit facility for the "home-building field."[29]

Like the Federal National Mortgage Association ("Fannie Mae"), the Federal Home Loan Mortgage Corporation ("Freddie Mac"), the Federal Agricultural Mortgage Corporation ("Farmer Mac"), the Farm Credit System and (before 2004) the Student Loan Marketing Association ("Sallie Mae"), the FHLBanks are government-sponsored entities ("GSEs").[30] Like the other GSEs, the FHLBanks are "quasi-governmental" organizations[31] that have "a Federal charter authorized by law; [are] privately owned, . . . with power to . . . make loans . . . for limited purposes such as to provide credit for specific borrowers or one sector; and raise funds by borrowing (which does not carry the full faith and credit of the Federal Government)."[32] Many believe that GSEs "benefi[t] from an implicit federal guarantee to enhance [their] . . . ability to borrow money;"[33] that investors treat GSEs, including the FHLBanks, as if the federal government "backs" the GSEs and would "make good on GSEs' debts and obligations in the event of a failure."[34] The U.S. government encouraged this idea when it rescued the Farm Credit System in the late 1980s and Fannie Mae and Freddie Mac in 2008.[35]

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[29] *Creation of a System of Federal Home Loan Banks*, *supra* note 26, at 14-15 (statement of Rep. Luce).

[30] RAYMOND E. OWENS, FEDERAL RESERVE BANK OF RICHMOND INSTRUMENTS OF THE MONEY MARKET, at 139-40 (1998) *available at*, http://richmondfed.org/publications/research/special_reports/instruments_of_the_money_market/pdf/chapter_11.pdf.

[31] KEVIN KOSAR, CRS REPORT FOR CONGRESS, RS21GG3, GOVERNMENT-SPONSORED ENTERPRISES (GSES): AN INSTITUTIONAL OVERVIEW CRS-1 (2007), *available at* http://www.fas.org/sgp/crs/misc/RS21663.pdf [hereinafter *CRS REPORT*] (characterizing the role of GSEs and the FHLBanks in particular).

[32] 2 U.S.C. § 622(8) (2006).

[33] Ronald C. Moe & Thomas H. Stanton, *Government-Sponsored Enterprises as Federal Instrumentalities: Reconciling Private Management with Public Accountability*, 49 PUB. ADMIN. REV. 321, 321(1989).

[34] CRS REPORT, *supra* note 31, at CRS-4; Flannery & Frame, *supra* note 24, at 35.

[35] Nathaniel C. Nash, *House Votes $4 Billion Aid For the Farm Credit System*, N.Y. TIMES, Dec. 19, 1987, at 37 Chris Isidore, *Fannie & Freddie:*

Because of this implicit federal guarantee, the FHLBanks are able to borrow money in the capital markets at interest rates "slightly above those available to the U.S. Treasury" and thus at lower rates than their private-sector competitors.[36] FHLBanks are then able to pass on these savings to their members in the form of collateralized financing.

A. Membership Requirements

The FHLB Act created twelve regional FHLBanks, each Bank serves a particular geographic area.[37] The System was originally supervised by a five-member FHLB board, each of its members selected by the President with the advice and consent of the Senate.[38] The FHLBanks originally derived capital from two sources: the U.S. government (though as stated in the 1932 hearings, the amount of capital subscribed by the U.S. was not to exceed $150 million) and from members who subscribe to stock in the FHLBanks.[39] Today, the FHLBanks are entirely privately capitalized.[40] FHLBanks are cooperative institutions, owned by the members in their region.[41] The FHLB Act's original 1931 proposal

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The Most Expensive Bailout, CNNMONEY.COM (July 27, 2009, 1:48 PM), http://money.cnn.com/2009/07/22/news/companies/fannie_freddie_bailout/index.htm (discussing the government takeover of Fannie Mae and Freddie Mac).

[36] RON J. FELDMAN & JASON SCHMIDT, FED. RESERVE BANK OF MINNEAPOLIS, FEDGAZETTE, FINANCIAL MODERNIZATION, THE FHLB AND AGRICULTURAL BANKS (2000), http://www.minneapolisfed.org/publications_papers/pub_display.cfm?id=2258; CRS REPORT, *supra* note 31, at CRS-6 ("GSEs borrow money at significantly lower interest rates than competitors because of the inferred federal guarantee and the government-bestowed privileges.").

[37] FHFB OFFICE OF SUPERVISION, EXAMINATION MANUAL APRIL 2007, OVERVIEW OF THE FHLBANK SYSTEM 2.1 (2007), *available at* http://ofheo.gov/Default.aspx/webfiles/2654/2.1_Overview_of _the_FHLBank_System-1.pdf.

[38] *Creation of a System of Federal Home Loan Banks*, *supra* note 26, at 17 (statement of Rep. O'Brien, Assistant Counsel, Office of the Legislative Counsel, House of Representatives).

[39] *Id.*

[40] FHLBanks Office of Finance, Membership, http://www.fhlb-of.com/ofweb_userWeb/pageBuilder/membership-32.

[41] *Id.*

limited membership to three categories of financial institutions: (1) building and loan ("B&L") associations, cooperative banks and homestead associations; (2) savings banks, trust companies and other banks each of which must be in financial condition (as determined by the FHLB Board) to grant long-term mortgage loans; and (3) insurance companies.[42] These three types of institutions were all "specialized mortgage lenders."[43] To become a member, qualified institutions purchase stock in their regional FHLBank.[44] Once members, these financial institutions receive dividends on the stock they own in the FHLBank and have access to the FHLBanks' low-cost loans, called advances.[45] Members, in turn, use those advances to fund loans (usually long-term residential mortgage loans) to individual customers.[46]

Since its creation in 1932, Congress has liberalized the FHLBanks' membership restrictions. The Financial Institutions Reform, Recovery and Enforcement Act of 1989 ("FIRREA") amended § 4(a) of the FHLB Act to open membership in the FHLBanks to commercial banks in good financial standing that held at least 10% of their assets in residential mortgage loans.[47] FIRREA was passed in response to the savings and loan crisis (the "S&L Crisis") of the 1980s. The 1989 liberalization of FHLB membership opened the door for commercial banks and credit unions, those hardest hit by the S&L Crisis, to benefit from the FHLBanks's low-cost funding option. Like the original FHLB Act, FIRREA used the FHLBanks to "promote, through regulatory reform, a safe and stable system of affordable housing finance" and to prop up a fledgling financial system.[48] Between 1992 and 1999, the number of FHLBank members more than doubled due to the opening of membership to

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[42] A Bill to create Federal Home Loan Banks, to provide for the supervision thereof, and for other purposes, H.R. 7620, 72nd Cong. § 4(a) (1st Sess. 1932).
[43] Flannery & Frame, *supra* note 24.
[44] H.R. 7620 72nd Cong. § 5(c).
[45] *Creation of a System of Federal Home Loan Banks*, *supra* note 26, at 17-18 (statement of Rep. O'Brien); *Banks Facts*, FHLB BOSTON http://www.fhlbboston.com/aboutus/thebank/08_01_02_bank_facts.jsp (last visited Feb. 28, 2010).
[46] *Frequently Asked Questions*, FHLBANKS, http://www.fhlbanks.com/overview_faqs.htm (last visited Apr. 8, 2011).
[47] Financial Institutions Reform, Recovery and Enforcement Act of 1989, Pub. L. No. 101-73, § 704, 103 Stat. 415, 416 (1989).
[48] *Id.* at § 101(1).

commercial banks and credit unions.[49] In 1992, community banks, a subset of commercial banks that serve their local communities, constituted 11% of the total FHLB members; in 1999 community banks constituted nearly 61% of FHLB members.[50]

Ten years after FIRREA opened up FHLB membership to commercial banks, the Gramm-Leach-Bliley Act of 1999 ("GLBA") further liberalized the FHLB membership requirements. GLBA allowed "community financial institutions" ("CFIs")—FDIC-insured banks with average assets under $500 million—to become members of the FHLB System regardless of the percent of assets consisting of residential mortgages.[51] This change, coupled with the liberalization of collateral requirements (discussed infra), opened FHLB membership up to the nation's agricultural banks, those banks with a ratio of agricultural loans to total loans exceeding 25%.[52] In 2008, the Housing and Economic Recovery Act ("HERA") increased the average asset amount for CFIs to $1 billion.[53] The GLBA and HERA changes allow community banks and credit unions to become members in the FHLB System even if they have little or no residential mortgage business. HERA also replaced the FHLB System regulator, the Federal Housing Finance Board, with the Federal Housing Finance Agency ("FHFA").[54]

HERA, passed in response to the economic crisis, also opened up FHLB membership to community development financial

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[49] Dusan Stojanovic, et al., *Is Federal Home Loan Bank Funding a Risky Business for the FDIC?*, THE REGIONAL ECONOMIST, 2000, *available at* http://stlouisfed.org/publications/re/articles/?id=482 (charting the growth of system membership in the 1990s).
[50] *Id.*
[51] Gramm-Leach-Bliley Financial Modernization Act, Pub. L. No. 106-102, § 605, 113 Stat. 1338, 1452 (1999); 12 U.S.C. § 1424(a)(4) (2008) ("A community financial institution that otherwise meets the requirements of paragraph (2) may become a member without regard to the percentage of its total assets that is represented by residential mortgage loans . . . .").
[52] FELDMAN & SCHMIDT, *supra* note 36 (arguing that the GLB Act will result in "virtually all of the nation's nearly 2,300 agricultural banks [becoming] eligible for FHLB membership").
[53] Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, § 1211, 122 Stat. 2654, 2790 (2008); 12 U.S.C.S. § 1422(10)(A)(ii) (2009).
[54] Housing and Economic Recovery Act § 1311 (giving the FHFA "general supervisory and regulatory authority" over the FHLB System) (2008); 12 U.S.C.S. § 4511(b) (2009).

institutions ("CDFIs").[55] CDFIs are intermediary financial institutions, including community development loan funds, venture capital funds and state-chartered credit unions, without federal deposit insurance.[56] CDFIs seeking to join the FHLB System must also make long-term home-mortgage loans and adhere to the 10% mortgage assets requirement.[57] CDFIs "promote economic growth and stability in low- and moderate-income communities."[58] CDFIs offer many financial products aimed at helping low-income homeowners or buyers including mortgage financing, counseling and financial literacy training.[59] CDFIs also offer products aimed at helping to establish additional low-income housing units ("financing for not-for-profit affordable housing developers") and small businesses ("commercial loans and investments to assist start-up businesses in low-income areas").[60] CDFIs were among some of the hardest hit by the current economic downturn.[61]

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[55] *Id.* at § 1206; 12 U.S.C.S. § 1424(a)(1) (2011).

[56] Federal Home Loan Bank Membership for Community Development Financial Institutions, 74 Fed. Reg. at 22,848.

[57] Federal Home Loan Bank Membership for Community Development Financial Institutions; Final Rule, 74 Fed. Reg. 678, 694 (Jan. 5, 2010) [hereinafter Final Rule, Supplementary Information] (to be codified at C.F.R. pts. 925 and 944) (requiring that the applicant be "deemed to make long-term mortgage loans" and the applicant has "at least 10 percent of its total assets in residential mortgage loans").

[58] *Id.* at 678.

[59] *Id.* ("[CDFIs] provide a unique range of financial products and services, such as mortgage financing for low-income and first-time homebuyers; homeowner or homebuyer counseling; . . . [and] financial literacy training;").

[60] *Id.*

[61] Chairman Ben Bernanke highlighted this development in a speech at the 2009 Global Literacy Summit in Washington, D.C.:

> In light of the mission of CDFIs, it is not surprising that their financial concerns often reflect economic distress in the broader community: the once-thriving local business that is shutting its doors, the affordable rental housing complex that is struggling to make payments as tenants lose jobs and fall behind, and the after-school youth center that cannot repay its loan because its donor base has shrunk. Even as the capacity of CDFIs has become more constrained, economic conditions and pullbacks by main-

By the end of September 2010, total membership in the FHLB System reached 7,916 members consisting of 5,753 commercial banks, 1,103 savings institutions, 1,017 credit unions and 222 insurance companies.[62] It is no coincidence that the liberalization of the membership requirements in the FHLB System correlated with major economic downturns. With HERA, as with the original FHLB Act itself and FIRREA, Congress used the FHLBanks to prop up a struggling financial sector hit hard by an economic downturn: the FHLB Act propped up the home mortgage industry during the Great Depression; FIRREA propped up community banks and credit unions after the S&L crisis; and HERA propped up the low-to-moderate income housing and home-financing industry during the current economic downturn. Each change indicates the utility of the FHLB System business model to promote long-term mortgages and the liquidity of the mortgage market, and to assist those sectors of the financial system hardest hit by economic downturns. Because it is arguably community banks that have been hardest hit by the current economic downturn, it is logical that the FHLBanks should be used to further assist these financial institutions and the communities they serve.

B. FHLB Advances and Collateral Requirements

FHLB advances are attractive to banks, especially community banks, for a number of reasons. FHLB advances are a more convenient and dependable form of funding than jumbo CDs or other forms of funding that can be withdrawn by holders seeking a higher interest rate.[63] Advances are a "nearly instantaneous" provision of liquidity.[64] Regional FHLBanks "customize the terms on advances to

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> stream lenders have increased the demands being placed on these organizations to provide credit and services.

Ben S. Bernanke, Chairman, Fed. Reserve, Speech at the Global Fin. Literacy Summit, Community Development Financial Institutions: Challenges and Opportunities (June 17, 2009) [hereinafter *Speech at Global Financial Literacy Summit*] (citations omitted) (transcript available at http://www.federalreserve.gov/newsevents/speech/bernanke20090617a. htm).

[62] *Membership*, FHLBANKS, http://www.fhlb-of.com/ofweb_userWeb/page Builder/membership-32 (last visited Apr. 8, 2011).

[63] Stojanovic et al., *supra* note 49.

[64] FHLBANKS, LIQUIDITY, http://www.fhlbanks.com/overview_liquidity. htm (last visited Feb. 27, 2010).

help their members manage interest rate risk."[65] Since FIRREA opened the door for community banks to become FHLB members, community banks have increased their reliance on the FHLB System.[66] As of December 21, 2009, the total outstanding advances were $631 billion.[67]

Members must pledge securities to receive advances.[68] Originally, the only qualifying securities were first mortgages on one to two family homes or leases that were renewable after (at least) ninety-nine years on residential units holding fewer than two families.[69] Like the FHLB membership requirements, Congress has loosened the collateral requirements for advances. In 1935, Congress amended Section 1430(a) to add "obligations of the United States, or obligations fully guaranteed to the United States" as allowable forms of collateral, which included Treasury and mortgage-backed securities issued by GSEs and FHLB cash or deposits.[70] In 1999, GLBA added Section 1430(a)(2)(B) that allowed advances to be used for "providing funds to any community financial institution for small businesses, small farms, and small agri-businesses."[71] GLBA also revised the collateral requirements to allow CFIs to pledge farm and small business loans as collateral, thus allowing community and agricultural banks to fund small business and agricultural loans with something other than deposits.[72] HERA added loans for community

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[65] Stojanovic et al., *supra* note 49.
[66] *See Id*. ("Between year-end 1992 and year-end 1999, community banks increased their reliance on FHLB funding from .2 percent of assets to 3.2 percent of assets.").
[67] *Financial Summary*, FHLBANKS, http://www.fhlbanks.com/overview_faqs_advances.htm#q6 (last visited Apr. 12, 2010).
[68] *See* Creation of a System of Federal Home Loan Banks, *supra* note 26, at 19 (statement of Rep. O'Brien).
[69] *See Id*; An Act to Create Federal Home Loan Banks, to Provide for the Supervision Thereof, and for Other Purposes, Pub. L. No. 72-304, § 2, 47 Stat. 725, 725 (1931) (amended 1935).
[70] Act of May 28, 1935, ch. 150, sec. 5, § 10(a), 49 Stat. 293, 294-95 (1935) (amending the FHLB Act to allow "obligations of the United States, or obligations fully guaranteed to the United States" as collateral).
[71] Gramm-Leach-Bliley Financial Modernization Act, Pub. L. No. 106-102, § 604, 113 Stat. 1338, 1451 (1999) (codified as amended at 12 U.S.C. § 1430(a)(2)(B) (2006)).
[72] *Id.* (codified as amended at 12 U.S.C. § 1430(a)(3)(E) (2006)); *see also FHLB Membership Becomes All Voluntary, More Open to Banks*, DIRECTORS & TRUSTEES DIGEST, Apr. 1, 2000, at 2.

development activities to that list.[73] Today, members are still required to pledge "high-quality collateral," however, that collateral can be in the form of government securities, small business loans, agricultural loans, community development loans or mortgages.[74] The liberalization of the types of allowable collateral used to procure advances and the allowable uses of advances, like the liberalization of FHLB membership, signals a push by Congress to prop up those areas of the economy worst hit by economic downturns: community and agricultural banks and the constituents they serve. Because small businesses are some of the institutions hardest hit by the current economic downturn—many of them are unable to find funding as banks are unwilling to lend—the current economic downturn provides an opportunity for the FHLB System to reorient its mission towards job creation by assisting its members in meeting the funding needs of America's small businesses.[75]

III. The Federal Home Loan Bank's Current Role in Job Creation

Although the traditional mission of the FHLB System is and has always been to prop up the home mortgage industry and the financial institutions that provide mortgages to their customers, the FHLB System has also made job creation a secondary, if unofficial, mission. In his State of the Union Address introducing the "Home-Loan Discount Bank System," President Hoover stated that the System "would revive residential construction and employment."[76]

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[73] Housing and Economic Recovery Act § 1211(b)(2) (2008) (codified as amended at 12 U.S.C.A. § 1430(a)(3)(E).

[74] *FHLBanks White Paper* 2 (Council of Fed. Home Loan Banks, White Paper, 2009), *available at* http://www.fhlbanks.com/assets/pdfs/sidebar/FHLBanksWhitePaper.pdf.

[75] *See* Emily Maltby & Stacy Cowley, *Credit Crunch Freezes Hiring, Expansion*, CNNMONEY.COM, (Sept. 25, 2008, 3:21 P.M.), http://money.cnn.com/2008/09/24/smallbusiness/small_biz_credit_freeze.smb/index.htm (quoting National Small Business Association President Todd McCracken: "If there is a squeeze on banks, even if only large investment banks, the repercussions can easily flow over into commercial bank loans. . . . [I]f banks have to pull back, they'll pull from small business loans first."); Robb Mandelbaum, *Obama Announces Small-Business Lending Push*, N.Y. TIMES, Oct. 22, 2009, at B4 (quoting President Obama, stating that "there's still too little credit flowing to our small businesses").

[76] *1931 State of the Union*, *supra* note 23, at 589.

This notion that the FHLB Act would also serve as a job creation vehicle was notably abandoned, however, during the Congressional hearings on the Bill:

> [T]his was heralded in the beginning as a kind of business revival proposition. It was supposed to be a means of stimulating home building and furnishing employment and a market for the disposition of home-building material. . . . The President in his advocacy of it said so, and so did Mr. Luce, the original author of this bill. It was soon discovered, however, that this was not a necessity, because there is now an overbuilt condition. There are thousands of homes vacant now throughout the country and there is little or no real necessity for an extensive building program at this time; and that idea, I think, has been largely, if not entirely abandoned.[77]

Although job creation was dropped from consideration as part of the FHLB System mission during the 1932 Congressional hearings—as the focus shifted to saving the B&L associations—job creation, especially jobs in the housing industry, has always flowed from the programs provided by the FHLBanks.[78] Just as President Hoover and Representative Luce believed in 1931, providing funding for first home mortgages loans naturally leads to job creation in the residential construction sector. Individual FHLBanks have also implemented voluntary programs with the purpose of stimulating job creation.[79] Two of the System's programs, the Affordable Housing

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[77] *Creation of a System of Federal Home Loan Banks*, *supra* note 26, at 32 (statement of Rep. Williams).

[78] *See id*. at 35-36 ("[Reimbursing B&L investors] is purely a secondary proposition, ... The purpose primarily is to permit [B&Ls] to get the money with which to pay their investors, and of course, if they are able to rearrange their financial condition it will be to their advantage.").

[79] *See Housing & Economic Growth: FHLB Economic Stimulus Advances*, FHLBBOSTON, http://www.fhlbboston.com/communitydevelopment/fundingprograms/esa/index.jsp (last visited Feb. 27, 2009) (detailing a program offering "discounted financing to members engaged in government-sponsored lending and investment activities or the development of self-directed initiatives designed to create growth in the economy, including the preservation and creation of jobs"); *Community Programs; Joint Opportunities for Building Success*, FHLBANKTOPEKA, http://www.

Program (AHP) and Community Development Advances (CDA), have experienced good to moderate success on the job creation front.

A. Affordable Housing Program

FIRREA established the AHP in 1989.[80] The AHP requires the FHLBanks to set aside at least 10% of their net income to support the creation and preservation of affordable housing.[81] The AHP is thus a mandatory program.[82] The twelve regional FHLBanks must allot a minimum of $100 million per year to fund the program.[83] This money "subsidize[s] the interest rate on advances to members engaged in lending for long term, low- and moderate-income, owner occupied and affordable rental housing at subsidized interest rates."[84] The FHLB Act defines low- to moderate-income, owner-occupied housing as those units owned by families with incomes at or below 80% of the local median income and for rental housing as those where at least 20% of the units will be occupied by "very low-income households."[85]

Since 1990, the AHP has assisted low- and moderate-income homeowners and first-time homebuyers as well as very-low income residents of rental housing in both rural and urban areas.[86] Additionally, AHP supports "special-needs households, including the elderly, the disabled, the homeless, or victims of domestic violence

fhlbtopeka.com/s/index.cfm?AID=33 (last visited Feb. 27, 2009) (detailing an economic initiative at FHLB Topeka that "assists members in promoting employment growth in their communities," by "facilitating entrepreneurship training and funding viable small business projects" and "infrastructure development that leads to increased employment opportunities").

[80] FED. HOUS. FIN. BD., REPORT OF THE HORIZONTAL REVIEW OF THE AFFORDABLE HOUSING PROGRAMS OF THE FEDERAL HOME LOAN BANKS 1 (2005) (hereinafter *FED. HOUS. FIN. BD.*).

[81] 12 U.S.C. § 1430(j)(5).

[82] *See* § 1430(j)(7) (stating that banks that fail to commit the required amounts must commit funds to an Affordable Housing Reserve Fund from which other FHLBanks may draw).

[83] 12 C.F.R. § 1291.2(a) (2009).

[84] 12 U.S.C. § 1430(j)(1).

[85] § 1430(j)(2)(A)-(B); *see generally* § 1430(j)(13) (defining "very low-income households" as those with "an income of 50 percent or less of the area median").

[86] *FED. HOUS. FIN. BD.*, *supra* note 80, at 1.

who need supportive services."[87] The AHP has provided advances that helped create more than 716,000 housing units and has provided more than $4 billion to fund affordable housing creation and preservation since 1990.[88] In 2004, three quarters of the units funded by the AHP's competitive grant program since 1990 were rental units.[89] The Homeownership Set-Aside Program, initiated in 1995 "to increase homeownership among low- and moderate-income households and to improve smaller and rural member access to the AHP," allows FHLBanks to set aside the larger of $4.5 million or 35% of their AHP funds for home purchases in designated areas.[90]

To help facilitate the AHP in each region, FIRREA required each regional FHLBank to establish an Advisory Council.[91] The Advisory Council is comprised of seven to fifteen persons "drawn from community and not-for-profit organizations that are actively involved in providing or promoting low- and moderate-income housing, and . . . in providing or promoting community lending" appointed by the FHLBank's board of directors.[92] The Advisory Council advises the FHLB on its selection criteria for AHP fund recipients as well as the elements of the AHP Implementation Program.[93]

The AHP creates jobs in both the construction and services sectors. The AHP creates construction jobs during the building and restoration of residential projects. In Boston, new affordable housing units are built using green-building techniques.[94] This can lead to additional jobs in the "green" construction industry, which supported over 2.4 million jobs nationally between 2000 and 2008 and is projected to support over 7.9 million jobs between 2009 and 2013.[95]

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[87] *Id.*

[88] *Affordable Housing Program*, FHLBANKS, http://www.fhlbanks.com/programs_affordhousing.htm (last visited Feb. 21, 2011).

[89] *FED. HOUS. FIN. BD.*, *supra* note 80, at 4.

[90] *Id.* at 7; 12 C.F.R. § 1291.2(b)(2)(A) (2008).

[91] 12 C.F.R. § 1291.4(a) (2009).

[92] *Id.*

[93] § 1291.4(d)(ii).

[94] FEDERAL HOME LOAN BANK OF BOSTON 2008 ADVISORY COUNCIL REPORT, 2008 FHLB BOSTON ANN. REP. 1.

[95] U.S. GREEN BUILDING COUNCIL, GREEN JOBS STUDY 5 (2009), *available at* http://www.usgbc.org/ShowFile.aspx?DocumentID=6435 [hereinafter *ADVISORY COUNCIL REPORT*]; *see also id.* at 1 ("Local and national policy-makers increasingly view green construction and renovation activities as an opportunity to spur domestic job creation because these jobs cannot be

The creation of new affordable housing units also induces consumer spending by the new residents that can help prop up the local economy. According to Housing First!, a coalition of groups committed to affordable housing in New York state, the cost per job of capital investment in affordable housing "compares favorably with spending on other essential infrastructure and economic development programs."[96] The addition of affordable housing developments to urban communities often encourages broader neighborhood development, adding new jobs in the construction and services sectors.[97] While job creation is a positive externality of the AHP, it is not the primary goal of the program. The FHLB thus does not record statistics showing the number of jobs actually created by housing developments supported by AHP funds. Because job creation is only an externality of the AHP, there is no mechanism for assuring that the advances provided will create or preserve jobs.

Moreover, because the regional FHLBank need only provide AHP funds if it makes a profit during the previous year, those funds, the affordable housing units they create or restore, and the jobs they support are dependent upon the regional FHLBank's ability to maintain consistent profitability.[98] In 2008, the combined net income for the 12 FHLBanks fell 57% from 2007; the drop meant that affordable housing contributions also decreased.[99] The FHLB of Boston did not make a contribution to its AHP in 2009 due to an annual net loss in 2008.[100] The AHP, despite its record of success in

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outsourced to other countries and require workers with new and traditional skills.").

[96] Press Release, Housing First!, State's Budget for Affordable Housing Undermines Job Creation and Federal Stimulus (Feb. 20, 2009), *available at* http://readme.readmedia.com/States-Budget-for-Affordable-Housing-Undermines-Job-Creation-and-Federal-Stimulus/408063.

[97] ADVISORY COUNCIL REPORT, *supra* note 95, at 5-6 (discussing the Dorchester Bay project, where the Ray & Joan Kroc Salvation Army Community Center decided to build a $100 million project after Dorchester Bay received a $300,000 AHP grant and constructed affordable housing units and commercial retail space).

[98] 12 C.F.R. § 1291.11 (2009) (allowing an FHLBank to temporarily suspend its contributions to the AHP if those contributions would contribute to the financial instability of the FHLBank).

[99] James R. Hagerty, *Financial Problems at FHLB Ripple Across Housing Projects*, WALL ST. J., Apr. 15, 2009, at C10 (estimating that 2009 contributions to the AHP would fall by about 40% to $188 million).

[100] ADVISORY COUNCIL REPORT, *supra* note 95, at 1.

promoting affordable housing, is pro-cyclical in the sense that funding is often diminished during periods of economic stress.

B. Community Development Advances and the Community Investment Program

Like the AHP, each FHLB operates a Community Investment Program ("CIP") that offers low-cost Community Development Advances ("CDAs") to members to be used for long-term financing for housing and economic development that benefits low- and moderate-income families and neighborhoods.[101] CDAs are used to finance the purchase, construction and rehabilitation of affordable housing; to support economic development initiatives like small business loans, social-service or public facility initiatives and infrastructure improvements as well as commercial, industrial and manufacturing initiatives; and to fund mixed use initiatives that combine affordable housing and economic development.[102] Commercial and mixed-use initiatives are eligible for CDAs if the initiative "creates or retains jobs for income-eligible workers" or if it qualifies as a small business.[103] Since 1990, the FHLB System has approved over $50 billion in CDAs and has created an estimated 78,000 jobs.[104]

While member banks are able to take advantage of the CIP, without a statutory mandate (like the AHP), the program remains underutilized. It is possible that CDFIs will provide new demand for CDAs. When discussing the admittance of CDFIs as members to the FHLB System, the Federal Housing Finance Agency stated:

> Frequently, CDFIs serve communities that are underserved by conventional financial institutions

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101 *Community Investment Program*, FHLBANKS, http://www.fhlbanks.com/programs_comminvest.htm (last visited Feb. 29, 2010).

102 *Community Development Advances—Overview*, FHLBBOSTON.COM, http://www.fhlbboston.com/communitydevelopment/fundingprograms/cda/index.jsp (last visited Feb. 28, 2010) (describing the various economic activities funded by CDAs).

103 *Community Development Advances—Economic Development*, FHLBBOSTON, http://www.fhlbboston.com/communitydevelopment/fundingprograms/cda/03_02_02b_eligible_econ_dev.jsp (last visited Feb. 28, 2010).

104 *Community Investment Program*, *supra* note 101.

> and may offer products and services that are not available from conventional financial institutions. . . . One common problem facing non-depository CDFIs, however is that they do not have access to long-term funding, which may limit their ability to provide housing finance to their communities.[105]

CDAs provide CDFIs with the long-term financing, to which they have not traditionally had access, to finance housing and economic development projects in low- to moderate-income communities.[106] Because the final rule allowing CDFIs to become members took effect in January 2010, we do not yet know what effect their inclusion will have on job creation.[107] The inclusion of CDFIs as members should increase the number of CDAs allotted by the FHLBs and, hopefully, the number of jobs created by these initiatives. Some predict that progress will prove slow, as the smaller CDFIs may have trouble convincing the FHLB of their safety and soundness and posting sufficient collateral to receive advances.[108] An increase in the demand for CDAs would almost certainly lead to the creation of new jobs. Maximizing the number and quality of jobs

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[105] Final Rule, Supplementary Information, *supra* note 57, at 4.
[106] *See* Speech at the Global Financial Literacy Summit, *supra* note 61:

> Other ongoing efforts to access institutional funding and the capital markets should continue so that CDFIs can tap more-reliable sources of funding at wholesale prices. For instance, the Federal Housing Finance Agency recently introduced its rules for public comment on how certified CDFIs can become members of the Federal Home Loan Bank System and access its lower-cost funds, as permitted under recent legislation. Such funding, with known pricing and terms, would be reliable and would help CDFIs manage their balance sheets more efficiently and inexpensively.

[107] Press Release, Federal Housing Finance Agency, FHFA Sends Final Rule to *Federal Register* for CDFIs to Become Members of FHLBs (Dec. 29, 2009), *available at* http://www.fhfa.gov/webfiles/15336/CDFIPR122909F.pdf.
[108] *See* Steven Sloan, *FHLBs May Not Get a Boost from New Members*, STRUCTUREDFINANCENEWS.COM (Jan. 6, 2010), http://www.structuredfinancenews.com/news/-201547-1.html?zkPrintable=true.

created by CDAs, however, requires a mechanism to assure that CDAs and the loans they fund go to those entities that will create the most jobs in growing industries.

C. Banking on Business Program

Unlike the AHP and CIP programs, the FHLB of Pittsburgh's Banking on Business ("BOB") program was created to stimulate job creation and preservation generally, not just in low- and moderate-income communities. BOB's objective is to "assist in the growth and development of small businesses, including both the start-up and expansion of these businesses."[109] BOB provides "recoverable assistance" to members in the form of non-collateralized loans used to fund "difficult or unbankable" small business loans.[110] The small businesses can use these loans to purchase buildings, real estate, machinery or equipment, construction, expansion, leasehold improvements, permanent working capital or closing costs.[111] The BOB funds are repaid to the FHLB of Pittsburgh by the member only on the ability of the small business to make the repayment.[112] If the loaning member demonstrates that the small business cannot repay the loan, recovery of the loan can be waived at the FHLB of Pittsburgh's discretion.[113] If the loan is repaid, it is repaid annually beginning one year from the issuance of the BOB loan.[114] The lending member bank earns up to 300 basis

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109 FHLB PITTSBURGH COMMUNITY INVESTMENT DEPARTMENT, BANKING ON BUSINESS PROGRAM BOOKLET AND INSTRUCTIONS MANUAL (2010), *available at* http://www.fhlb-pgh.com/pdfs/cid/bobfundmanual.pdf (last visited Mar. 28, 2010) [hereinafter BOB INSTRUCTIONS MANUAL].

110 *Id.*; *see also Banking on Business* Fact sheet, FHLBANK PITTSBURGH, http://www.fhlb-pgh.com/pdfs/cid/BOB_Fact_sheet.pdf [hereinafter BOB Fact Sheet] (describing how one FHLB absorbs the risk taken on by members when they originate risky small business loans). The BOB Instructions Manual defines a small business as one with fewer than fifty employees and having annual receipts less than $10 million and within receipt limits set by the SBA. BOB loans are not available to any small business that would otherwise be able to draw from AHP or CIP funds.

111 *Banking on Business*, FHLBANK PITTSBURGH, http://www.fhlb-pgh.com/housing-and-community/programs/banking-on-business.html (last visited Mar. 28, 2010).

112 BOB INSTRUCTIONS MANUAL, *supra* note 109.

113 *Id.*

114 *Id.*

points per year on the BOB loan during the second and all subsequent years of repayment.[115] BOB thus benefits the loaning member by mitigating its risk, allowing the member to earn additional income on the BOB loans and encouraging new relationships with small businesses that can lead to long-term customers for the member bank. It benefits the FHLB of Pittsburgh by generating member advances; and it benefits the communities served by the small businesses by BOB loans' ability to create and preserve jobs, "increas[e] property values" and provide "additional tax revenues."[116]

To assure that BOB loans create or preserve jobs, BOB requires members to monitor the small business's use of the funds, the number of jobs created or preserved and the economic impact the small business (and the BOB loan) has had on the community. Since 2010, BOB has required members to submit an Employment Certification Form for each small business borrower that verifies the borrower's current (pre-BOB loan) employment levels and estimates the borrower's employment levels one year and also three years after receipt of the BOB loan.[117] The Employment Certification Form also requires the member to describe the strategy the recipient business plans to employ to ensure that jobs will be created or retained.[118] If a recipient business has not retained or created one full time equivalent ("FTE") job for every $25,000 BOB funds requested, the member must submit an Economic Impact Description Form.[119] The Economic Impact Description Form allows a member to explain, in narrative form, how a BOB loan had or will have a positive economic impact on the community.[120] These "other economic impact[s]" include construction activities such as labor created or materials purchased; fees paid to attorneys, realtors, title insurers or banks; municipality benefits such as taxes, permits or trash removal; enhancement or expansion of other local businesses; member bank benefits like cross selling opportunities; or if the business would

[115] *Id.*

[116] *BOB Fact Sheet*, *supra* note 110 (quoting Bob Davis, Vice President, Community Bank & Trust).

[117] BOB INSTRUCTIONS MANUAL, *supra* note 109.

[118] *Id.*

[119] *Id.* Thus, if a small business requests the maximum $200,000 in BOB funding, it must preserve or create eight FTE jobs within one year of receiving the funds.

[120] *Id.*

close without the BOB funding.[121] The FHLB of Pittsburgh reviews the materials provided by the member lender and can approve, deny or reduce the amount of BOB funds allotted to the small business at its discretion.[122] At the time of the initial BOB loan expenditure and annually thereafter, the loaning member must also submit a Performance Measurement Review. The Review must include the recipient business's employment summary, including the number of employees for each job type and the number of FTEs by position.[123] All of these forms assure not only that the BOB loan is being used to create or preserve jobs, but that the members are intimately aware of the loan recipient's business plan and ability to create or preserve jobs.

The FHLB of Pittsburgh has provided $43 million in BOB funding and created or preserved over 5,400 jobs since the program's inception in 2000.[124] In 2010, the FHLB of Pittsburgh set aside $3.5 million for BOB loans.[125] Over $500,000 of those funds are earmarked for Blueprint Communities, a group of 41 distressed communities in Delaware, Pennsylvania and West Virginia selected because they are older communities and neighborhoods in need of revitalization.[126] The BOB program's targeted approach to job creation and its ability to "keep track" of how its funds are being used to create or preserve jobs provides some best practices that can be utilized by the entire FHLB System in making the FHLB System a job creation vehicle.

IV. Changing the Mission: the Federal Home Loan Bank System as a Job Creation Mechanism

Though job creation was dropped from the System's official mission during the 1932 Congressional hearings (discussed above in Part III), the AHP, CIP, inclusion of CDFIs as members and programs like BOB have had a limited role in moving job creation

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121 *Id.*
122 *Id.*
123 *Id.*
124 *Banking on Business Success Stories*, FHLBANK PITTSBURGH, http://www.fhlb-pgh.com/housing-and-community/real-life-stories/banking-on-business.html (last visited Apr. 13, 2010).
125 *Banking on Business*, *supra* note 111.
126 *Id.*; *Blueprint Communities*, FHLBANK PITTSBURGH, http://www.blueprintcommunities.com/wv/whatis.html (last visited Mar. 28, 2010).

and job retention forward as a priority for the System.[127] With the increase in unemployment due largely to employers' lack of access to credit facilities, job creation should now become a central part of the FHLB System's overall mission.[128] Unemployed or underemployed Americans cannot invest in their homes or purchase new homes.

The Federal Housing Finance Authority defines the FHLBanks' mission as follows: "The mission of the Banks is to provide to their members' [sic] and housing associates financial products and services, . . . that assist and enhance such members' and housing associates [sic] financing" of housing and "community lending."[129] Community lending "means providing financing for economic development projects for targeted beneficiaries, and, for community financial institutions . . . purchasing or funding small business loans, small farm loans or small agribusiness loans."[130] While job creation is implicitly included in the official mission of the FHLB System, the full impact of the System on job growth is impeded by the regulation of this function and by its being tethered to economic development. Recent comments made by Michael J. Guttau, Chairman of the Council of Federal Home Loan Banks, give voice to the prospect of job creation becoming a primary goal of the FHLB System.[131] Despite the inclusion of job creation in the FHLB

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[127] *Federal Home Loan Bank (FHLBank) System*, ABA.COM, http://www.aba.com/Issues/Issues_FHLBSystem.htm ("ABA strongly supports maintenance of a cooperatively based FHLBank System with a primary mission of providing banks with access to advances for housing and community development lending.").

[128] Dan Levy, *Foreclosures in U.S. Rose 81%, Topping 2.3 Million Last Year*, BLOOMBERG.COM (Jan. 15, 2010, 12:01 P.M.), http://www.bloomberg.com/apps/news?pid=20601087&sid=asgBXeQ.u5Lg&refer=home.

[129] 12 C.F.R. § 940.2 (2009).

[130] 12 C.F.R. § 900.2 (2009).

[131] Michael J. Guttau, Chairman, Council of Fed. Home Loan Banks, Address to the FHLBank Directors Conference: The Job We Do (Apr. 22, 2009):

> As always, it is our job to serve the needs of those who create the economic strength of our cities, towns and rural communities. That's because local economies need a stable source of credit *to support job creation and the housing markets*. Community banks are the financing engines for local economies across the nation. And the

System's regulations and recent mention of job creation as a goal in public forums, home mortgage creation continues to be the primary mission of the FHLB System. In July 2010, the GAO reported that the FHLBanks, with the wide discretion granted to them by the FHFA, have established policies—such as not accepting certain types of alternative collateral and requiring high haircuts for that alternative collateral—that have discouraged or prevented the creation of small business and agricultural loans.[132] The FHFA has the authority to make job creation and preservation a co-equal goal with housing. The FHFA has the authority to amend its regulations, specifically Section 940.2(b) (the section that mentions community lending), to include commercial lending *that promotes job creation and job preservation*.[133] In 2008, HERA officially recognized "community development" as part of the mission of the FHLBanks.[134] Thus the FHFA, if it defines "community development" broadly, already has the authorization of Congress to elevate job creation as a mission critical function. The July 2010 GAO Report stated that the FHFA has failed to take the required steps to ensure that the FHLBanks create small business and agricultural loans.[135] The FHFA, as the GAO Report notes, "has an obligation to take reasonable steps to help ensure that the FHLB System is achieving the missions for which it was established, including economic development."[136]

The FHFA is unlikely to propose a rule that alters the mission of the FHLB System without a further act of Congress or a directive from President Obama spurring the agency to action. An act of Congress requiring the FHLB System to elevate job creation to a

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> Federal Home Loan Banks have always been a critical component of community bank's funding of new loans, especially during economic crisis (emphasis added).

[132] U.S. GOV'T ACCOUNTABILITY OFFICE, OVERSIGHT OF THE FEDERAL HOME LOAN BANK'S AGRICULTURAL AND SMALL BUSINESS COLLATERAL POLICIES COULD BE IMPROVED 27 (July 2010) [hereinafter *GAO REPORT*].

[133] Because the FHLB mission already includes "community lending," and because FHLBanks have already established programs like Pittsburgh's BOB, a rule proposing to reform the System should satisfy any judicial challenge under *Chevron v. Natural Resources Defense Council*, 467 U.S. 837 (1984).

[134] Housing and Economic Recovery Act, Pub. L. No. 110-289, § 1201, 122 Stat. 2654, 2782 (2008).

[135] GAO REPORT, *supra* note 132, at 27.

[136] *Id.*

core mission could mirror in part the Federal Housing Enterprises Financial Safety and Soundness Act of 1992, which mandated that the U.S. Department of Housing and Urban Development set low-income housing goals for the housing GSEs.[137] A new act would thus produce a section similar to Section 1430c of the FHLB Act, which authorizes the Director to "establish housing goals with respect to the purchase of mortgages" that are consistent with the job creation goals established by the Federal Housing Enterprises Act.[138] While a legislative initiative altering the mission of the FHLB System could provide a clear directive to the FHFA and the FHLB System, it could also prove to be slow and ultimately ineffective. After a drawn-out battles over healthcare and the budget today's Congress is far more fractured and partisan than it was in 2009.[139] Though job creation is a more popular topic for both political parties than healthcare, immigration or climate change legislation, the chances of a jobs reform bill passing both houses without a protracted partisan battle are slim.[140]

A more practical option is for President Obama to issue an executive order directing the FHLB System to make the goal of job creation a priority on par with housing creation. This step could be taken in connection with the appointment of a new permanent Director of the FHFA and as an important element of GSE reform.[141] Since taking office, President Obama has issued 80 executive orders. Like President Obama's establishment of the President's Economic Recovery Advisory Board, the executive order should recite: "[b]y the authority vested in [the President] by the Constitution and the laws of the United States of America, and in order to enhance the strength and competitiveness of the Nation's economy and the

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[137] 12 U.S.C. §§ 4561-4564 (2006).

[138] 12 U.S.C. § 1430c(a)-(b) (2006) ("[T]he Director shall consider the unique mission and ownership structure of the Federal Home Loan Banks.").

[139] Jim Tankersley & Peter Nicholas, *For Obama, Too Soon for Another Partisan Battle*, LATIMES,Apr. 4, 2010,, http://www.latimes.com/news/health/healthcare/la-na-obama-what-now4-2010apr04,0,3375824.story (stating that, after the healthcare victory, Obama seems disinclined to attempt another "all-in battle this year").

[140] *Id.*

[141] Since August of 2009, the FHFA has been led by an acting Director. *See* Dawn Kopecki, *FHFA's Lockhart Stepping Down, Treasury Official Says*, BLOOMBERG.COM (Aug. 5, 2009, 12:53 P.M.), http://www.bloomberg.com/apps/news?pid=newsarchive&sid=aiUceMB8EaKs.

prosperity of the American people" and direct the new leader of the FHLB System to make job creation a critical part of its official mission.[142] An executive order may prove more efficient and achievable than an act of Congress and it would serve as a predicate for the following three recommendations.

V. *Three Job Creation Proposals for the FHLB: A Focus on Community Banks and Small Businesses*

As President Obama looks for new ways to promote job creation, his focus has correctly shifted to small businesses. Small businesses have created the "majority of new jobs over the past decade and, in past downturns, it's been small business growth that has pulled us out of recession."[143] According to the SBA Office of Advocacy, small businesses generated 65% of net new jobs in the private sector between 1983 and 2008.[144] Small businesses need funds in the form of small business or commercial loans "to open their doors, expand, and hire more workers," in other words, to preserve and create jobs.[145] Community banks are often the main source of credit for small businesses.[146] Community banks make 20% of all small business loans and 50% of all small business loans under $100,000.[147] Since the beginning of the current economic downturn

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142 Exec. Order No. 13,501, 74 Fed. Reg. E9-3112 (Feb. 6, 2009); *see Youngstown Sheet & Tube Co. v. Sawyer*, 343 U.S. 579, 585 (U.S. 1952) ("The President's power, if any, to issue the order must stem either from an act of Congress or from the Constitution itself.").

143 Stacy Mitchell, *supra* note 19.

144 Press Release, Small Business Administration Office of Advocacy, Where Do Jobs Come From? New Analysis of Job Gains and Losses from the Office of Advocacy (Mar. 3, 2010), *available at* http://www.sba.gov/advo/press/10-03.html.

145 Press Release, The White House Office of the Press Secretary (Feb. 5, 2010), http://www.sba.gov/idc/groups/public/documents/sba_homepage/sba_rcvry_new_busines_proposal.pdf. (quoting President Obama, "The true engine of job creation will always be business. What government can do is fuel that engine . . . .").

146 Stacy Mitchell, *supra* note 19.

147 Stacy Perman, *Community Banks Increase Small Business Loans*, BUSINESSWEEK.COM (Jan. 27, 2009, 8:19 A.M.), http://www.businessweek.com/smallbiz/content/jan2009/sb20090127_581741.htm (referencing the work of Paul Merski, an economist with the Independent Community Bankers of America group).

banks have continually decreased their small business lending, leaving community banks to further fill the role of small business lender.[148] The ability of small banks to meet this challenge has been impeded by their own asset quality problems, especially with respect to construction lending, as well as concerns with economic conditions in general.

Job creation and retention initiatives should thus focus on the connection between community banks and small businesses. The following are three recommendations for enhancing this connection: make job creation loans (small business, farm and commercial and industrial loans) a more viable form of collateral for advances; expand the FHLBanks' membership base to include those nonbank institutions that are already lending to small businesses; and create an AHP-like program for job creation. Taken together or separately, and augmented by REFCORP funds as described below, these steps would be substantial contributors to the "reformed" FHLB System.

A. Make Small Business, Farm and Commercial and Industrial Loans Viable Collateral for Advances

Though the Gramm-Leach-Bliley Act liberalized collateral requirements to include small business and farm loans, residential mortgages remain "the principal form of collateral for advances."[149] Mortgages remain the predominant form of collateralization of advances because FHLBanks treat small business and farm loans differently than they do mortgages. Advances made against pledged farm and small business loans are typically granted at less than the typical eighty cents on the dollar granted against mortgages.[150] The FHLB of Boston values mortgage loans and mortgage backed securities ("MBSs") issued or guaranteed by Fannie Mae or Freddie Mac at 80-90% of the "lower of book value or market value as

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[148] U.S. DEP'T. OF THE TREASURY, *Bank Lending Surveys*, FINANCIALSTABILITY.GOV, http://www.treasury.gov/initiatives/financial-stability/results/cpp/bank-lending/Pages/default.aspx (last visited Feb. 20, 2010) (detailing a 4.6% decrease in big bank lending to small businesses between April and November 2009).

[149] *Federal Home Loan Bank System Lending and Collateral Q&A*, FHLBANKS (Mar. 30, 2010), *available at* http://www.fhlb-of.com/faqs/lendingqanda.pdf (last visited Apr. 5. 2010).

[150] FELDMAN & SCHMIDT, *supra* note 36 ("[A]gricultural banks that are actively borrowing from the FHLB have the lowest deposit-to-loan ratios.").

determined by the Bank," while valuing small business, farm and agribusiness loans at just 50%.[151]

While each regional FHLB creates its own policies to assess and mitigate credit risk, each FHLBank values small business loans at lower rates than mortgages and MBSs.[152] This difference in valuation makes it less likely that community banks will pledge small business, commercial or farm loans as collateral. When given a choice between receiving nearly a 1:1 ratio for mortgage and MBS collateral as opposed to 1:2 ratio for small business loans, a bank with both loans on hand will choose to pledge the mortgage loans if for no other reason than to avoid additional paperwork Because community banks cannot readily turn small business loans into liquidity (in the form of advances), member banks grant fewer loans to small businesses in need of financing. Valuing small business loans at the same rate as mortgages and MBSs could thus increase the number of small business loans extended by member banks.

The difference in valuations between mortgages and MBSs and small business loans reflects the perceived risk of small business loans.[153] Small businesses are all different, ranging from "small grocery stores to professional practices to small manufacturers. This heterogeneity, together with widely varying uses of borrowed funds, has impeded the development of general standards for assessing small business loan applications."[154] These differences make the underwriting of small business loans difficult and costly. They can also create information asymmetries between the business and the

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[151] *Appendix A: Qualified Collateral*, FHLBBOSTON, http://www.fhlbboston.com/productsandservices/productpolicy/downloads/01_08_12_appendix_a.pdf (last visited Apr. 6, 2010).

[152] *See Federal Home Loan Bank System Lending & Collateral Q&A,* FEDERAL HOME LOAN BANK,(Nov. 16, 2009), http://www.fhlb-of.com/faqs/lendingqanda.pdf.

[153] Amy C. Bushaw, *Small Business Loan Pools: Testing the Waters*, 2 J. SMALL & EMERGING BUS. L. 197, 200 (Summer 1998) ("Some suggest that there will always be a shortage of financing for small businesses, given the lack of information on these businesses and the commensurate high risks of lending to them.").

[154] KENNETH TEMKIN & ROGER C. KORMENDI, AN EXPLORATION OF A SECONDARY MARKET FOR SMALL BUSINESS LOANS, U.S. SMALL BUSINESS ASSOCIATION OFFICE OF ADVOCACY 5 (2003) (quoting BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, REPORT TO THE CONGRESS OF THE AVAILABILITY CREDIT TO SMALL BUSINESSES, REPORT 29, (1998)).

lender and thus increase the perception of risk.[155] Small business loans also present "payment timing risks" in that lenders carrying prepaid loans may be unable to reinvest those funds at a comparable rate and loans in which repayment is delayed may face similar problems.[156] Because banks must continually monitor small business loans, these loans are more costly to administer than prime residential mortgages.[157] To reduce and reallocate these risks and costs, some scholars suggest creating a secondary market for small business loans.[158]

Just as the U.S. government encouraged home ownership with the creation of a secondary market for residential mortgages, the securitization of small business loans could encourage job creation.[159] The creation of a secondary market for small business loans has become more realistic in recent years with the increased popularity of credit scoring and the "increasingly standardized documentation" used for these loans.[160] Just as the creation of a secondary market for residential mortgages led to the uniform documentation and underwriting standards for home mortgages, so too could a secondary market for small business loans further encourage the creation of more uniform underwriting and documentation standards for small business loans.[161]

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[155] Bushaw, *supra* note 153, at 256; *see also* TEMKIN & KORMENDI, *supra* note 154, at 5-6 (stating that these asymmetries in information give community banks a competitive advantage over large banks in loaning to small businesses due to "relationship underwriting based on personal knowledge of the firm, its owners, and their prospects" that small banks can use to ameliorate information asymmetries).

[156] Bushaw, *supra* note 153, at 228.

[157] *See* Press Release, Small Business Administration Office of Advocacy, Small Banks Profit from Relationship Lending (May 4, 2007), http://www.sba.gov/advo/press/07-14.html.

[158] *See generally* Bushaw, *supra* note 153; TEMKIN & KORMENDI, *supra* note 154.

[159] Bushaw, *supra* note 153, at 216-17.

[160] *Id.* at 247.

[161] Eduardo F. Rodriguez, Comment, *Ask Not What Your Government Can Do for You. Ask What Your Government Can Do for Small Business: A Proposal for Government Involvement in the Securitization of Conventional Small Business Loans*, 2 FIU L. REV. 143, 147, 150 (2007) (citing Joseph C. Shenker & Anthony J. Colletta, *Asset Securitization: Evolution, Current Issues and New Frontiers*, 69 TEX. L. REV. 1369, 1385 (1991)) (stating that

A secondary market for small business loans could lead to a more efficient means of assessing the risk of a small business loan, thus reducing information asymmetries and the perceived risk of the loan. Pooling small business loans could lead to a "more stable and cheaper source of funding for banks."[162] A reduction in the perceived risk of small business loans should also lead to a reduction in the haircut for the loans required by the regional FHLBanks and thus increase the number of small business loans pledged by member banks as collateral for advances. An increase in the valuation of small business loans would thus encourage member banks to provide more small business loans.

Professor Amy C. Bushaw states that one of the "practical impediments" to the creation of a secondary market for small business loans is that "[f]ew banks can amass a sufficiently large portfolio of small business loans that are relatively homogenous as to underwriting standards, credit quality and documentation" necessary for the actuarial assessment of small business loan pools.[163] The increased use of small business loans as collateral for FHLB advances could solve this problem in two ways: first, if the FHLB System were to systemically increase the number of small business loans it accepts as collateral for advances, thus increasing the number of small business loans in the market place, it becomes more likely that a private sector firm can find a sufficient number of "similar" (in terms of size, risk profile and payment schedule) small business loans to pool; second, the FHLB System with the information it amassed regarding these small business loans, could step-in to take over the role assumed by Fannie Mae and Ginnie Mae in the securitization of residential mortgage loans, purchasing and securitizing small business loans.[164]

Some suggest that a secondary market for small business loans requires the involvement of a GSE, stating that "public support could reduce initial reluctance in the marketplace to accept small business loan pools"[165] and would provide "an implicit guarantee that principal and interest payments will be made in a timely manner."[166]

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a more uniform documentation and underwriting standard would make it easier to predict the payment patterns of conventional small business loans).

[162] Bushaw *supra* note 153, at 251.

[163] *Id.* at 247.

[164] Rodriguez, *supra* note 161, at 150.

[165] Bushaw, *supra* note 153, at 253.

[166] Rodriguez, *supra* note 161, at 172.

While the FHLB System may not be in the best position to take on the role assumed by Ginnie Mae and Fannie Mae for home mortgage securities, another GSE could be created to do so. Professor Bushaw notes that, as Fannie Mae, Freddie Mac and Ginnie Mae paved the way for the private pooling of mortgages, a new GSE could also pave the way for the private pooling of job creating small business loans.[167] However, Professor Bushaw also notes that, because a GSE could "crowd out" private sector initiatives to securitize small business loans, that these private sector actors should be allowed to "satisfy the need before Congress steps in."[168]

The high haircut required on small business loans is not the only hindrance to community banks' use of certain job-creation loans as collateral for FHLB advances. Because each regional FHLB reserves the right to "refuse certain types of real estate loans considered high-risk or special purpose property loans to be pledged as collateral," many loans that could create jobs cannot be pledged.[169] The Boston FHLB defines "high-risk properties" as those that "are management intensive, have limited improvements, are subject to the effects of toxic or hazardous materials or substances, or the property is subject to a ground lease."[170] "Special purpose property" includes those properties, which have "limited marketability due to their [unique] design or use."[171] These definitions necessarily encompass many commercial real estate properties that house some of the nation's fastest growing industries, including: assisted living facilities, hospital and veterinary treatment centers and gaming facilities.[172] The regional Banks also place burdensome filing

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[167] Bushaw, *supra* note 153, at 253.

[168] *Id.* at 255-56.

[169] *Attachment B, Excluded Commercial Real Estate Property Types,* FHLB BOSTON, http://www.fhlbboston.com/members/forms_and_apps/downloads/collateral/excluded_cre_types.pdf.

[170] *Id.*

[171] *Id.*

[172] *Id.*; Tara Weiss, *Fastest-Growing Industries*, FORBES.COM, (Sept. 26, 2008,11:55 A.M.), http://www.forbes.com/2008/09/26/fastest-growing-industries-lead-careers-cx_tw_0926jobgrowth.html (listing health care as the second fastest growing industry, fueled in part by an increase in the percentage of the U.S. population that is sixty five and older); *In the year 2016: The 30 fastest-growing jobs*, BOSTON.COM, http://www.boston.com/jobs/galleries/30fastest_growing_occupations (last visited Apr. 22, 2010) (projecting that health care providers, veterinarians, veterinary

requirements on commercial loans.[173] The fact that these are booming industries suggests that they are no longer of "limited marketability." Relaxing the restrictions on "high-risk" and "special use" commercial real estate properties and reducing the restrictions on the use of commercial real estate loans as collateral would further enhance the FHLBanks' ability to create and preserve jobs.

As with the extension of lending powers initiated by the GLBA, there is concern that an increased use of small business and commercial real estate loans (even theoretically "less risky" small business loan securities) as collateral for advances will be perceived as risky and will "likely . . . increase taxpayer exposure to bank loses" due to the implicit government guaranty.[174] However, alleviating information asymmetries and decreasing the FHLBanks' haircut to reflect the true risk-level of small business loans and the increased regulation of credit rating agencies should not place the FHLB System in any peril.[175] Also, it should be noted that despite the GLBA's liberalization of collateral requirements, no FHLB has ever incurred a loss on an advance.[176] Moreover, it is likely that a more effective use of the administration's $30 billion TARP job creation program would be the dedication of a portion of that fund to a program that guarantees FHLBank advances on small business job producing loans.

An increase in the number of small business loans used as collateral and financed by FHLB advances does not, by itself, assure job creation. Therefore, as FHLBanks accept more small business loans as collateral and issue more advances for the purpose of funding small business loans, FHLBanks should also utilize some of the best practices of the FHLB of Pittsburgh's Banking on Business

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technicians and jobs in the gaming industry will be among the thirty fastest growing jobs in the next five years).

[173] *Template for CRE Loans*, FHLB BOSTON http://www.fhlbboston.com/members/forms_and_apps/05_02_02_collateral_forms.jsp (last visited Feb. 28, 2010) (follow the Template for CRE Loans link).

[174] Ben R. Craig & James B. Thompson, *Federal Home Loan Bank Lending to Community Banks: Are Targeted Subsidies Necessary?* (FRB of Cleveland, Working Paper No. 01-12), *available at* http://www.clevelandfed.org/Research/workpaper/2001/Wp0112.pdf.

[175] *See* David Leonhardt, *Heading Off the Next Financial Crisis*, N.Y. TIMES MAG., Mar. 28, 2010, at MM36, available at http://www.nytimes.com/2010/03/28/magazine/28Reform-t.html.

[176] *Safety and Soundness*, FHLBANKS.COM, http://fhlbanks.com/overview_safety.htm (last visited Apr. 7, 2010).

Program (discussed above) to assure that the loans they finance are creating and preserving jobs. With the information provided in the Employment Certification and Economic Impact forms, regional FHLBanks can monitor the impact of their advances on the job market of particular communities and selectively fund those advances that are likely to have the largest effect on job creation and preservation in needy communities.

B. Expanding FHLB Membership

As the credit crunch worsens for small business owners, many look to alternative sources of funding. Some small business owners have turned to asset-based lenders for funds when they, "don't have the credit ratings, track record or patience to pursue more traditional capital sources."[177] Asset-based lenders accept a small business's liquid assets such as accounts receivable, inventory or equipment as collateral for their loans.[178] The Commercial Finance Association reports that asset-based lending, excluding mortgages, increased by 8.3% in 2008 and may see a double-digit increase in 2009.[179] Other small business owners are turning to companies offering purchase-order financing.[180] Similar to asset-based lending, purchase-order financing (which is most often used by companies that sell goods manufactured abroad) allows businesses to assign purchase-orders to a lending company in exchange for money paid up-front. The company assumes the costs of billing and shipping the merchandise; when the purchase-finance company receives payment from the receiver of the goods, it takes its cut and gives the rest of the money to the original lender.[181] With both asset-based lending and purchase-order financing, if a business defaults on its loan, the lender takes possession of the inventory, merchandise or accounts receivables used as collateral.[182] Still another type of lender that has seen an increase in loans to small businesses since the beginning of

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[177] Kyle Stock, *Asset-Based Lending Grows in Popularity*, WALL ST. J., Feb. 2, 2010, at B5.
[178] *Id.*
[179] *Id.*
[180] Andrew Martin, *The Places They Go When Banks Say No*, N.Y. TIMES, Jan. 31, 2010, p. BU1, available at http://dealbook.nytimes.com/2010/02/01/the-places-they-go-when-banks-say-no/.
[181] *Id.*
[182] *Id.*

the economic downturn are lenders who base their loans on a company's cash flow rather than the company's assets or credit score.[183] These lenders, like On Deck, a cash-flow lender based in New York City, require that borrowers be open for more than one year and that they earn at least $3,000 in monthly credit card sales or have an average daily checking balance of more than $3,000 to acquire credit.[184] On Deck provides $30,000 loans that must be paid back within one year.[185] The "catch" is that rather than receive a monthly bill, On Deck deducts a small payment from the borrower's checking account each day.[186]

Asset-based lenders, companies who participate in purchase-order financing and cash-flow lenders like On Deck all make loans that can be used to cover the start-up costs of a new business: they can be used to buy inventory, make store expansions and pay salaries. These non-traditional lenders thus provide funds that can be used to both preserve existing jobs and create new jobs. For some small businesses, these non-traditional lenders are the only reliable source of financing.

Asset-based lenders and those who participate in purchase-order financing attach liens to a company's existing assets before providing financing and rely less on a company's credit scores or assessments of the company's ability to repay the loans before lending.[187] This allows the lenders to offer financing faster than a traditional lender. In exchange for speed, both of these non-traditional lenders charge higher interest rates than banks dealing in traditional small business loans.[188] Because the loans provided by these two types of lenders are fully collateralized they, in some ways, carry less risk for the System than traditional small business loans. Thus, allowing asset-based lenders and purchase-order financing

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[183] Ryan McCarthy, *Loans You Pay Back Every Day*, INC.COM (May 1, 2009),http://www.inc.com/magazine/20090501/loans-you-pay-every-day.html.
[184] *Id.*
[185] *Id.*
[186] *Id.*
[187] Martin, *supra* note 180; Stock, *supra* note 177 (noting that asset-based lenders prefer to work with companies whose collateral can be quickly turned to cash if need be).
[188] Martin, *supra* note 180 (comparing purchase-order finance loans to loan sharking); Stock, *supra* note 177 ("In addition to the relatively high rates, asset-based loans are secured; lenders can legally seize assets if the borrower misses payments.").

companies to become members of the FHLB System would not expose the System to additional risk. The FHLB System's implicit government guaranty could enable the lenders to lower their interest rates. However, the fact that these two types of non-traditional lenders secure their loans with liens may not make them ideal candidates for FHLB membership. When one of these non-traditional lender's loans falls through, the lender is left with inventory which it may not be able to convert into sufficient funds to cover its losses.[189] The Federal Housing Finance Agency warns that "[g]ranting membership to an ineligible entity or failing to perform sufficient due diligence in the approval process can potentially expose the FHLBank to significant risk, especially credit and operational risk."[190] Because these lenders do not rely on the credit worthiness of their small business customers, the loans they provide are inherently risky, most likely too risky for the FHLB System.

Cash-flow lenders like On Deck, however, may be ideal candidates for membership in the FHLB system. On Deck uses proprietary software to review a prospective loan recipient's sales history and banking records to evaluate a small business's performance.[191] Using "newly available online reports from banks, credit bureaus, and credit card providers," On Deck is able to reduce the information asymmetries inherent in small business lending and determine the credit worthiness of a business in "about two days."[192] On Deck further hedges against the risk of its loans by withdrawing its repayment from the recipient's checking account every day rather than at the end of the month. Thus, allowing On Deck and lenders using a similar business model to become members of the FHLB System would not increase the FHLB System's exposure to risk. As members, companies like On Deck would have access to the FHLB System's low-cost funds and could thus reduce the interest rates charged on their small business loans. Cash-flow lenders like On Deck would also benefit from the level of legitimacy becoming a member of the FHLB System would entail, this could increase the number and quality of its customers. However, none of these non-

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[189] Martin, *supra* note 180 (stating that non-traditional lenders can be left with everything from boxes of auto parts to women's sandals).
[190] FHFB OFFICE OF SUPERVISION, EXAMINATION MANUAL APRIL 2007, MEMBERSHIP 20.1 (2007), *available at* http://ofheo.gov/Default.aspx/webfiles/2654/20.1 Membership-1.pdf.
[191] McCarthy, *supra* note 183.
[192] *Id.*

traditional lenders are regulated, making them inherently more risk-prone than community banks, which may preclude their inclusion as members of the FHLB System.

C. AHP-Like Program for Job Creation

Though controversial at its creation, the AHP has increased FHLB membership and the visibility of the FHLB System in certain communities.[193] The program receives top billing on the FHLB and regional FHLB websites. As part of a reformed System with job creation as a mission-critical function, the AHP model could easily and successfully be adapted to promote job creation.

Since the beginning of the current economic downturn, small businesses have faced an unaccommodating credit market; placing an influx of funds into the system could alleviate the credit crunch.[194] As with the AHP, the FHLBanks could allot a percentage of their net profits to fund small business, construction, commercial and industrial and other job-creating loans, not merely for community or economic development purposes, but as part of their core business activity. Ideally the program should be mandated by statute to assure participation, however this is not essential. Several FHLBanks further incentivize the AHP by linking FHLBank president compensation and bonuses to community investment activities.[195] The jobs program could use a similar approach. Like the AHP, the program should have an Advisory Council comprised of members of the local community with experience and expertise in job creation, including small business owners, entrepreneurs and representatives of state and local government. Boards of Trade could also help to supervise the allocation of funds to members and to formulate criteria to assess the credit worthiness of individual proposed projects. Administrators of

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[193] FED. HOUS. FIN. BD., *supra* note 80, at 20 ("Some board members and senior Bank managers in our surveys, however, view the AHP principally as a tax and a drain on earnings.").

[194] Martin, *supra* note 180 ("Small-business owners say banks routinely reject applications for loans that were readily available just two years ago."); Press Release, U.S. Small Business Admin Office of Advocacy, Financing, Sales Were Small Firm Concerns of 2008 (July 8, 2009) http://www.sba.gov/advo/press/09-11.html.

[195] FED. HOUS. FIN. BD., *supra* note 80, at 21 (stating that at least five of the twelve FHLBanks give weight to community investment activities in determining FHLB president salaries and bonuses).

the FHLBanks, with the help of the Advisory Council, should urge their members to become involved in job creation lending by, among other things, learning about local enterprises and employment needs in the communities they serve. Stressing to community banks that, like the creation of affordable housing, job creation loans and projects can also provide positive publicity, profitability and the number of customers could further induce members to participate in a job-creation program.[196]

FHLBanks could designate another 10% of their net earnings to fund the program; however, the FHLBanks may have an alternative source of funding. In 1989, FIRREA imposed an "income tax" on the twelve FHLBanks, requiring the FHLBanks to make a fixed annual payment of $300 million to cover a portion of interest on the Resolution Funding Corporation (REFCORP) bonds used to finance the thrift cleanup.[197] The GLBA revised the FHLB REFCORP obligation to require a repayment of 20% of FHLB annual net profits.[198] The FHLBanks are expected to fulfill this obligation ahead of schedule, possibly by 2013.[199] With this debt repaid, the funds formerly used to repay the REFCORP debt could be devoted to the new job-creation program. If necessary TARP funds formerly intended to be distributed to the banks could be utilized to shore up FHLB Bank balance sheets. Critics of the original REFCORP requirement suggest that the requirement forced FHLBanks to focus on profitability and thus encouraged risky behavior.[200] Placing another REFCORP-like requirement on the FHLB System may continue to encourage risky behavior in an entity with only an implicit federal guarantee at a time when risk-taking is

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[196] *Neighborhood Works Greater Manchester Named 2008 Champion in Action for Affordable Housing*, THE NEIGHBORHOOD MINUTE, (2008), at 1, *available at* http://nwgm.org/uploads/pdf/news/Newsletter%20spring%2008.pdf (discussing Citizen's Bank involvement with the Silver Mill affordable housing project in Manchester, NH an FHLB AHP sponsored program); John Tozzi, *A 'Systemic Shift' in Small Business Lending*, BUSINESSWEEK (Jan. 22, 2010, 1:31 PM) http://www.businessweek.com/print/smallbiz/content/jan2010/sb20100120_126461.htm (describing Goldman Sach's announcement of its $500 million dollar initiative to fund small business loans by, in part lending to CDFIs as a "PR move").

[197] Flannery & Frame, *supra* note 24, at 33-34; 12 U.S.C. § 1441a (2006).

[198] Gramm-Leach-Bliley Financial Modernization Act, Pub. L. No. 106-102, § 607, 113 Stat. 1338, 1455-56 (1999).

[199] Hagerty, *supra* note 99.

[200] Flannery & Frame, *supra* note 24, at 34.

strongly discouraged. However, these fears can be placated with continued regulatory oversight by the FHFA, and by the joint and several liability structure of the FHLB System.[201]

VI. Conclusion

Small businesses created a majority of all new jobs in the last decade.[202] President Obama's plan to provide $30 billion of TARP funds to community banks to fund small business loans is a step in the right direction, but remains a flawed plan. Community banks have already expressed fear that accepting TARP funds will cause them to be "tarred by their competitors as troubled."[203] Rather than fund a jobs program with the unpopular TARP funds, President Obama, as part of his GSE reform program, should utilize the unique structure of the Federal Home Loan Bank System and its close ties with community banks to create and preserve jobs. Though traditionally thought of as a mortgage creation vehicle, the job creation has been a secondary goal of the FHLB System since its inception in 1932. By altering the mission of the FHLB System to make job creation a priority, the FHLB System can be effectively utilized to promote job creation in a variety of ways.

This paper provides three suggestions that utilize the existing system of the FHLB to promote job creation and promotion: (1) making small business and other job-creation loans a more viable and readily accessible source of collateral for advances; (2) expanding the membership of the FHLB System to include firms that are lending to small businesses; and (3) creating an AHP-like jobs-creation program with the support of funding that formerly went to pay down REFCORP obligations. Changing the mission of the FHLB System to make job creation a primary goal would allow for

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[201] *Safety and Soundness*, *supra* note 176.
[202] Stacy Mitchell, *supra* note 19.
[203] Elizabeth Williamson, *Obama Rolls Out Small Business Lending Program*, WALL ST. J., Feb. 2, 2010, http://online.wsj.com/article/SB10001424052748704022804575040722955784294.html?mod=djemalertnews; *see* Darrell A. Hughes, *TARP Stigma is Curtailing Bank Lending, Treasury's Allison Says*, WALL ST. J., Feb. 26, 2010, http://online.wsj.com/article/SB10001424052748704625004575089370496737074.html?mod=WSJ_latestheadlines (describing banks' fear of being labeled a 'TARP recipient' in negative advertising, competitors use the label to call a bank's soundness into question).

the use of a pre-existing structure with a channel directly into over 8,000 community banks. These banks have the ability to increase the amount of credit available to small businesses and thus allow those businesses to immediately create new jobs and the preservation of others.