

Collateral Sharing Arrangements Between Federal Home Loan Banks and Federal Reserve Banks

Bill Nelson | March 5, 2024

With the recent heightened attention on discount window collateral, a quick review of how Federal Reserve Banks and Federal Home Loan Banks divide up each FHLB member bank's collateral may be useful.

There are 11 FHLBs and 12 FRBs, and their regions are not contiguous. Each bank must enter into a unique bilateral lending, collateral pledge and security agreement with its FRB and with its FHLB to be able to borrow. At the end of 2023, there was \$527 billion of FHLB advances outstanding to 2,256 banks, more than half of all banks.

Both FHLBs and FRBs will only lend against collateral in which they have a perfected security interest, meaning that if the borrower defaults, they have the clear legal right to acquire the collateral to recover the payment obligation. Moreover, both lend against loans in addition to securities. As reported in [Plassman and Rosa \(2023\)](#), for the banks that borrowed at least once from the discount window during four quarters ending in 2021Q3, 80 percent of the prepositioned collateral was in the form of loans, including 40 percent consumer loans and 20 percent commercial loans.

All FHLBs offer members a specific pledge lien agreement or a blanket lien agreement. According to the FHFA, “[t]he most commonly used agreement is a blanket lien, under which the FHLBank’s security interest attaches to all of a member’s assets or, in some cases, to specified categories of a member’s assets.”¹ When a member enters into a blanket lien agreement with an FHLB, the FHLB has a claim on all the assets of the borrowing member that are included in the related UCC filing, as opposed to liens supported by specific collateral. The FHLBs only provide lending value against a subset of these assets, called eligible collateral, which includes mortgages, commercial real estate loans, agency MBS and certain other mortgage-related and other assets. But in the event the borrowing member fails, all the pledged assets of the member against which other lenders do not have a perfected security interest are available to help repay the indebtedness to the FHLB if the eligible collateral is insufficient. In an edge case where eligible collateral is insufficient to pay back FHLB indebtedness, the FHLB has a priority interest versus unsecured creditors in collateral to which it does not extend lending value.²

If a FHLB member wishes to maintain collateral at the discount window, the FHLB and the FRB identify asset types either by call report item or via a loan listing for the bank to pledge to the Fed. The FHLB subrogates its first-lien priority interest on those items. For example, the FHLB, FRB, and the bank may identify consumer loans – credit card, auto and other non-RE loans to households – as an asset category the bank will use to establish discount window borrowing capacity and for which the FHLB relinquishes its blanket lien.

Both the FHLBs and the FRBs accept loan collateral primarily through borrower-in-custody agreements, meaning the bank rather than the FHLB or FRB maintains possession of the loan documents and notes. The loans are instead

¹ Federal Housing Finance Agency, “Report on Collateral Pledged to Federal Home Loan Banks,” December 2023, p. 3. <https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/2023-Annual-Collateral-Report-to-Congress.pdf>

² The FRBs and FHLBs have a provision in the FDIA that prevents the FDIC from disallowing FRB/FHLB claims relating to borrowing or the pledge of collateral. See 12 U.S.C. 1821(d)(5)(D)(iii).

maintained at the bank and the bank provides the FHLB or FRB periodic reports on the characteristics of the loans in the BIC. The FHLB or FRB uses that information to discount, i.e., haircut, the book value or estimated market value, and in the case of securities, actual market value, to determine the borrowing capacity.

Because possession or control of collateral always trumps priority interest obtained by filing a financing statement, similar conflicts do not arise over book-entry securities. To pledge a security to an FRB or FHLB, the bank moves the security into a segregated pledge account at the lending agency or its custodian, providing that agency with a perfected interest via control in the security.

An additional wrinkle concerns the relative timing of the FHLB and FRB filings of claims against collateral. If the Fed submits a UCC filing against pledged collateral before the FHLB, the Fed's claim on pledged collateral may be superior to the FHLB's blanket lien.

One implication of the FHLB's blanket lien and these interagency agreements is that a much larger percentage of commercial bank assets may be encumbered than some may assume. For example, a recent report by the Group of Thirty concluded that, after accounting for "already pledged securities," no mid-sized bank other than SVB would be unable to pledge sufficient collateral to the discount window to establish borrowing capacity greater than uninsured deposits, and that only 10 of 931 banks in the small-sized category would have insufficient collateral.³ Nevertheless, these conclusions may not account for the fact that potentially all the loans of any FHLB member that is borrowing from an FHLB are encumbered apart from those already specifically carved out for pledging to other creditors.

Thus, as reported efforts to encourage banks to be prepared to borrow from the discount window progress, a collateral knot with the FHLBs must be untied.

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³ Group of Thirty, "Bank Failures And Contagion, Lender Of Last Resort, Liquidity, And Risk Management," January 2024, pp 11-12. https://group30.org/images/uploads/publications/G30_Lessons-23-Crisis_RPT_Final.pdf