The Daily Dish

The Second Coming of the GSEs

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Remember Fannie Mae and Freddie Mac, the cute, clever government-sponsored enterprises (GSEs)? The guys who had boatloads of special privileges – a line of credit at the Treasury, exemptions from securities registration requirements, microscopic capital backstops, the ability to have their debt held in unlimited amounts by banks, and the highly risky and hugely profitable monoline housing-based hedge funds, and more. Those GSEs made millions by convincing markets that they were implicitly guaranteed by the taxpayer until…it all came crashing down in 2008. The implicit taxpayer backing became an explicit drain on the Treasury, and the GSEs became (and remain) wards of the state.

The bad old GSEs are back. Not Fannie and Freddie, but their evil stepcousin, the Federal Home Loan Banks (FHLBs). *The Economist* recently noted in "Another bank subsidy America should kill off" that:

> The FHLBs fund their loans by selling their debt to investors (after the Treasury, they are the world's second-biggest issuers of dollar-denominated bonds). They are owned by their member institutions but their debt is presumed by investors to be all but guaranteed by the government. They are also exempt from some taxes, among other privileges. The result is their debt trades at a similar yield to Treasuries, allowing the FHLBs to lend at below-market interest rates to banks, which also share in the FHLBs' profits. In all the FHLBs dole out an implicit subsidy that researchers valued at around $5.5bn in 2022, when the FHLBs were smaller than they are today.

That sounds exactly like the GSEs prior to their fall. There are other similarities. The FHLB system was set up in the 1930s to back housing assets and promote homeownership. Sound familiar? But it has since outlived its original purpose, suffering from enormous mission drift. In particular, the FHLBs are essentially a lender of last resort, providing liquidity to banks when the system is in stress. Per *The Economist*, "In the spring of 2023 'advances' to its members—which include life insurers and others as well as banks—passed $1trn for the first time since the global financial crisis, up from just $335bn at the end of 2021. Today advances are about $800bn, incorporating both the run-of-the-mill lending and more recent demand for crisis liquidity."

If one wants, one can ignore these issues. But one cannot dodge the fact that the FHLB network issued $30 billion in loans to Silicon Valley Bank, Silvergate, and Signature Bank shortly before each collapsed.