

# The Causes and Effects of Commercial Bank Participation in the Federal Home Loan Bank System

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(ABSTRACT)

The 1990s saw significant increases in commercial bank membership in the Federal Home Loan Bank (FHLB) System and extensive growths in FHLB assets and outstanding advances. Since FHLB policies may enable risk-taking behavior by the System's member institutions, this research evaluates the impact of the FHLBs on community bank members, local consumers, and local markets.

Results suggest that commercial bank liquidity is enhanced by and managed with the use of System advances, and investments in loans and mortgage-related assets increase with FHLB participation, particularly by small bank members. Credit quality and bank financial conditions improve after participating in the FHLB program, and cost savings from borrowing System funds may contribute to higher rates paid on deposits in local markets. However, banks with greater exposure to interest rate risk are more likely to become FHLB members, and interest rate risk exposure further increases after membership attainment, as the amount of advances borrowed increases, and the longer members remain in the FHLB program. Long-term advances have not been used to lengthen liability duration to offset growth in long-term asset investments, which makes the FHLB System more highly susceptible to rising rates.