

GSE REFORM AND THE FEDERAL HOME LOAN BANK SYSTEM

HEARING

BEFORE THE
SUBCOMMITTEE ON
CAPITAL MARKETS, INSURANCE AND
GOVERNMENT SPONSORED ENTERPRISES
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U.S. HOUSE OF REPRESENTATIVES
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GSE REFORM AND THE FEDERAL HOME LOAN BANK SYSTEM

Wednesday, March 9, 2005

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE
AND GOVERNMENT SPONSORED ENTERPRISES

Washington, D.C.

The subcommittee met, pursuant to call, at 10:05 a.m., in Room 2128, Rayburn House Office Building, Hon. Richard Baker [chairman of the subcommittee] presiding.

Present: Representatives Baker, Gillmor, Castle, Royce, Kelly, Biggert, Miller of California, Kennedy, Barrett, Feeney, Davis of Kentucky, Fitzpatrick, Kanjorski, Meeks, Frank, Baca, Scott, Velazquez, Watt, Davis of Alabama, Wasserman Schultz, and Maloney.

Chairman BAKER. [Presiding.] I would like to call this meeting of the Committee on Capital Markets to order this morning.

The subcommittee meets today for the purpose of receipt of testimony on the current regulatory oversight of the Federal Home Loan Bank System and the appropriateness of examining and consideration of modifications in light of pending reform to government-sponsored enterprise regulations.

The bank system was established in 1932 to help facilitate liquidity for the extension of credit for the purchase of homes by individuals. Today, the bank system is composed of 12 separate districts with approximately 8,000 members in the system and is enjoying a growth in its programmatic and financial activities as a result of several legislative changes throughout the years, principally the Modernization Act in 1999.

Of continuing interest to members of the committee is the relationship between the bank system and the taxpayers and the balancing of its social charter. The Secretary of the Treasury under certain limited conditions is authorized to extend up to \$4 billion of credit to the system in the case of financial reversal.

What is interesting to note, as we have seen the disclosures relative to Fannie Mae and Freddie Mac, which much of the national news attention has been given, is that similar growth patterns exist among all GSEs. Although the bank system today holds about \$115 billion of mortgages, not necessarily that significant as contrasted with Fannie or Freddie, equaling about 7 percent of their \$1.6 trillion currently held, the rate of growth has been significant and the amount of debt issuances is at \$774 billion, while Fannie at \$976 billion and Freddie at \$757 billion.

So the system itself has great potential for growth, and is it the question of the committee whether the authorities granted to the system and the required programmatic activities are sufficiently being met in light of the significant growth, and whether in the current debate over GSE reform significant attention should be given to bank system activities and the adequacy of the current regulatory structure.

I wish to point out to the bank system's credit, I believe, that their EDP Program, the Economic Development Program, the Community Investment Program, CIP Program, and others are significant assets to local communities, and with the expansion of the appropriate, to include small business lending and agricultural, there is the potential for the bank system to provide meaningful service to communities that frankly is not available anywhere else, particularly for the small bank, or the community bank as they are typically called, who tends to be more of a portfolio lender holding the obligation in their own institution.

This is a credit window allowing significant cost advantage for product and significant length of term, which makes it a very attractive facilitator for the extension of credit to small growth in rural communities.

For that reason, I am very much of an advocate of the system but do look forward to hearing from our witnesses today as to their perspectives on the adequacy of our current regulatory structure.

With that, I recognize Mr. Kanjorski for an opening statement.

Mr. KANJORSKI. Thank you, Mr. Chairman.

We meet today to discuss the regulation of the Federal Home Loan Banks. As you know, Mr. Chairman, I share your deep interest in these important financial institutions. After all, we worked closely together for several years to include language to reform the Federal Home Loan Banks during our deliberations over the 1999 law to modernize the financial services industry.

Among other things, these reforms strengthened the corporate governance of the Federal Home Loan Banks, updated their capital structure and established voluntary membership on equal terms and conditions for all eligible institutions. They also expanded access to the system for small community financial institutions. The changes additionally have helped to pave the way for enhanced targeted economic development lending.

Although some of my colleagues may think the issue is a new one, we have debated how to best regulate the Federal Home Loan Banks for a number of years. Like the regulation of Fannie Mae and Freddie Mac, my goal has been to ensure that we have strong, world-class and independent regulation for the Federal Home Loan Banks.

The current safety and soundness regulation of the Federal Home Loan Banks is actually better than that of the other government-sponsored enterprises. The Federal Housing Finance Board, unlike the Office of Federal Housing Enterprise Oversight, is funded outside of the congressional appropriations process. In addition, a previous survey by the Government Accounting Office determined that the Finance Board has powers that are substantially better than OFHEO's authorities, because these authorities more closely align with those of the banking regulators.

Because the Finance Board already has many of the powers that it needs and because the structure of the Federal Home Loan Banks is significantly different from the other housing GSEs, my preference continues to be to consider regulatory changes for these institutions on separate tracks from any regulatory reform bill for Fannie Mae and Freddie Mac. With its increased emphasis on safety and soundness supervision in recent years, the Finance Board has become increasingly more effective in monitoring the Federal Home Loan Banks.

That said, I recognize that there is a strong push by some to incorporate the Federal Home Loan Banks into any forthcoming GSE reform bill. If we therefore do include the system in the regulatory overhaul, we need to ensure that such legislation will protect the unique nature of the Federal Home Loan Banks and not negatively affect the cost of funds. I also want to ensure that the system can continue to build on its community and economic development initiatives that we authorized 6 years ago.

Another important concern for me is the need to ensure that an independent voice continues to be heard on the boards of the Federal Home Loan Banks. Public interest directors have an important role to play in corporate governance. Some of the reforms that we have enacted in recent years have gone too far in limiting the compensation that they can receive for their services.

We need to increase the pay of directors in order to ensure that we can attract quality directors to serve on boards and effectively monitor sophisticated financial products and strategies. We ought to also increase the length of the term of all directors. Finally, we should ensure that directors are appointed in a timely manner.

One final issue that I hope we will address today concerns registration with the Securities and Exchange Commission. Last year, the Finance Board approved a rule to require the banks to register their stock with the Commission, even though such stock is not publicly traded. The banks are now working toward implementing that plan. I do, however, have concerns about how such registration will interplay with the joint-and-several liability of the system. I therefore hope that our witnesses today will address this issue.

In closing, Mr. Chairman, I commend you for your sustained leadership in these matters and look forward to hearing from our witnesses today.

Chairman BAKER. Thank the gentleman for his statement.

Mr. Barrett?

Mr. Fitzpatrick?

Mr. FITZPATRICK. Thank you, Chairman Baker.

With the improper accounting practices at Fannie Mae and Freddie Mac, this committee has raised serious concerns about that adequacy of the current regulatory environment for housing-related government-sponsored enterprises.

Despite being a new member of this committee, it is apparent to me that there is a great need to change the GSE's regulatory structure. Legislative proposals have been introduced to create an independent regulatory, not only for Fannie Mae and Freddie Mac, but also for the Federal Home Loan Banks.

In America, we have a great story to tell. The United States homeownership rate has reached a record 69.2 percent in the sec-

ond quarter of 2004, and the number of homeowners in the United States reached 73.4 million—the most ever. And for the first time, the majority of minorities in America own their own homes, and this is also the experience in my district in southeastern Pennsylvania.

Due to this success, we must ensure that GSE reform does not hinder the housing industry. The regulatory must be independent and have supervision and enforcement powers nearing those of federal banking regulators. The regulator also has to recognize that the Federal Home Loan Bank System has a different mission, structure and capital backing than Fannie Mae and Freddie Mac. Nonetheless, I believe that the benefits of a combined regulator would outweigh the costs.

Ultimately, we must be certain that we are protecting the home buyer. These home buyers are the families of the 8th Congressional District of Pennsylvania. I need to know in what way housing-related GSE reform would affect their everyday lives before we proceed.

I yield back my time, Mr. Chairman.

Chairman BAKER. I thank the gentleman.

Mr. Frank?

Mr. FRANK. Thank you, Mr. Chairman.

I agree with much of what the gentleman from Pennsylvania, the ranking minority member of the subcommittee, had to say. If it were up to me, we would not be putting the Federal Home Loan Banks in with Fannie Mae and Freddie Mac. I accept the argument that I heard from many that market perception really forces us to do this. Namely, if we were not to include the Federal Home Loan Banks here, the market would misread this in some ways and there could be problems.

I am drawing up a list, Mr. Chairman. This is an area, the question of receivership for Fannie Mae and Freddie Mac, how we treat stock options. I have a long list of things that we are being urged to do primarily because if we do not do them, the market will misread what we are doing.

When I hear people preach to me the unerring intelligence of the market in general, I think about the number of occasions when this committee is pressed to do things because the market will get it wrong if we do not make some cosmetic changes, including the Federal Home Loan Banks in the same regulator with the GSEs is fairly cosmetic. They are different institutions, they will be regulated in different ways, but we will put them in the same overall box in the organization chart. That will apparently be of some comfort to investors, far be it for me to deny these people comfort. I just hope they will not take this as one more sign of their acuity.

On the Federal Home Loan Banks, it is important that we not disrupt the system that seems to me to be working well, in particular. I was here when under the leadership of Henry Gonzalez, whose picture was there, we created, over bitter partisan opposition at the time, the Affordable Housing Program. It was a very close vote on the floor of the House of Representatives. Today, it is one of the few areas where we continue to make money available for the construction of subsidized housing. It has worked superbly.

I am pleased to note that one of the later witnesses will be from Boston, Mr. Miller, from the Wainwright bank. The Wainwright bank has been a great example of a socially responsible institution, and we have benefited from the Affordable Housing Program.

Housing has been very important in this country, economically and socially. The existence of 30-year fixed mortgages as a main option for a lot of people we must not jeopardize that.

I would mention one specific point that I would hope we will deal with, and it deals with the Affordable Housing Program. The Affordable Housing Program dispenses funds as a percentage of where the activity has occurred, and it dispenses those funds—well it dispenses the funds according to the banks that are members of the particular regional bank.

When we passed that in the eighties, mergers were not nearly the rage that they are today. The result is that today we have a lot more activity being conducted in one area but being credited because of a merger to another area, and that creates a disparity.

The notion of the Affordable Housing Program was that money would be spent on affordable housing to some extent in the areas where the banks earned it. In Boston, now, we have had a couple of mergers, the Sovereign Bank-Compass Bank one in particular where an out-of-state bank, headquartered I believe in the Pittsburgh district, now does a lot of business in Boston.

I am very grateful, both to the home loan bank system, the Pittsburgh and Boston banks and to Sovereign bank for some ad hoc arrangements that dealt with that, but I would hope we would find some systemic way that this does not have to reach the issue of multiple bank membership. What I would like to see is that for the Affordable Housing Program purposes we get a form of accounting so that the original purpose is not defeated by mergers and that economic activity in a particular area will generate money for affordable housing in that area.

But, overall, I do not think that radical surgery of any sort is needed here, and I accept the fact that we will be doing an overall bill, and I hope that we will come out with something that looks, frankly, very much like what we now have with regard to the home loan banks.

Chairman BAKER. I thank the gentleman and make the observation that if that affordable housing standard were made applicable to Fannie's \$900 billion investment portfolio, that could yield some real benefits.

Mr. FRANK. If the gentleman would yield, as he knows, he is talking about something we have already been advocating. And in fact thanks to the Senator from Rhode Island, Mr. Reed, it was in the Senate bill, which would have passed if the administration did not pull the plug on it. And it is in every proposal that we have made, so we very much agree.

And I would also point out to the gentleman that what we are doing, if he would just yield me 30 more seconds, the Affordable Housing Program is a percentage of the profits, which means—and I want to apply that to Fannie Mae and Freddie Mac. I want a percentage of what they do to go to affordable housing, which of course means that if you succeed in shrinking them, you will succeed in shrinking the amount that goes into affordable housing.

Chairman BAKER. I thank the gentleman for his observations and agree. I think we actually could do both. I think we can increase the amount available to affordable housing, shrink their portfolio and everybody wins.

Mr. FRANK. Well, I would just to the gentleman, if he would yield further since we are apparently debating the substance, you get a percentage, and the smaller their overall activity, the smaller the percentage, either of the affordable housing goals or of the profits that go along with the Affordable Housing Program.

Chairman BAKER. Oh, I agree. I am just saying they do nothing now. We could certainly improve off nothing.

Ms. Kelly?

Mrs. KELLY. Thank you, Mr. Chairman.

Believing in the ownership society, I fully support what the Federal Home Loan Banks have been doing in providing access to home ownership in various ways. I am concerned that with the bill that we are to do that we not create a dislocation in the housing market in any way. I think that is what my colleague was referring to.

That said, I applaud what home loan banks have been doing, and I certainly look forward to the testimony of the witnesses today.

I applaud you, Mr. Chairman, for holding this hearing so that we can actually hear from the people who are helping Americans own homes.

I yield back.

Chairman BAKER. Thank the gentlelady.

Ms. Wasserman Schultz?

Ms. WASSERMAN SCHULTZ. Thank you, Chairman Baker, Ranking Member Kanjorski and members of both panels.

For the sake of time, I would like to limit my opening statement because I am eager to hear from the panelists, but I do want to express the concern that I know that many members have, that the public interest directors for the Federal Home Loan Banks have not been appointed.

And what this decision has done is it has increased the risk for the corporate governance structure for the Federal Home Loan bank of Atlanta, specifically which serves the institutions that I represent in Florida.

The three appointed directors of the bank, whose terms have expired, were among the board's most experienced directors who possess special industry knowledge and expertise that added value to the governing ability of the bank's board.

Their vacancies leave \$130 billion financial institution's board operating without a newly elected chairman, and that deeply concerns me.

Thank you. I yield back the balance of my time.

Chairman BAKER. I thank the gentlelady.

Mr. Castle, did you have a statement? Mr. Castle? Did you have a statement?

Mr. Davis?

Mr. DAVIS OF KENTUCKY. Thank you, Mr. Chairman. Housing issues are deeply personal to me. When I was a young child, our congressman cut through federal bureaucratic red tape to help my mom get our first house, and it changed our lives. I am looking for-

ward to this dialogue on goals and transition in the Federal Home Loan Banks, like our own excellent Cincinnati branch, and hope that it can continue to adapt to the markets and also provide a platform to help people transition into ownership.

Thank you for being here. I yield back my time.

Chairman BAKER. Thank the gentleman.

Mr. Watt?

Mr. Royce?

Mr. ROYCE. Thank you, Mr. Chairman. I thank you for holding this hearing on GSE reform and the federal home loan bank System, and I would like to commend you again for your continued leadership on GSE oversight and reform.

For some time, I have been a strong advocate of regulatory reform for all three housing GSEs: For Fannie Mae, Freddie Mac and the Federal Home Loan Bank System. In the last Congress, I proposed legislation to create a single regulator for all three entities, and in my view, this is the right policy because all three present similar risks to the financial system.

Since unveiling my legislation in June of 2003, there have been numerous headlines about problems at all three housing GSEs. The accounting troubles at Fannie Mae and Freddie Mac seem to have overshadowed the issue in the Federal Home Loan Bank System, but in the past 2 years seven of the 12 Federal Home Loan Banks have been downgraded or put on negative watch by Standard & Poors. The S&P took these steps because of the increased interest rate risk and/or the decreased profitability at the seven banks.

The interest rate risk in the Federal Home Loan Bank System has increased markedly as the individual banks have stepped up their purchases of mortgage assets. If managed improperly, this risk could put the entire safety and soundness of the system in jeopardy.

I was pleased to read Chairman Rosenfeld's prepared testimony in which he asserts that interest rate risk oversight is the Finance Board's top priority. I encourage the Finance Board to be vigilant in this undertaking.

In addition to our important oversight role in this committee, I hope that we will move swiftly to create a new regulatory structure for Fannie Mae and Freddie Mac and the Federal Home Loan Banks. There is a very simple solution: Congress must create a new regulator with powers at least equal to those of other financial regulators, such as the OCC or the Federal Reserve.

I hope this committee will heed the advice coming from Chairman Greenspan, coming from the entire Board of Governors, coming from the Federal Reserve staff, the U.S. Treasury Department, the OECD, coming from the IMF and from countless others who have urged Congress to act.

And, Mr. Chairman, thank you again for your leadership. I yield back.

Chairman BAKER. I thank the gentleman for his statement and look forward to working with him on legislation yet to be considered.

Mr. Feeney? There is no statement?

Is there any other member desiring to make an opening statement?

If not, at this time, I would turn to our first witness, the chairman of the Federal Housing Finance Board, the Honorable Ronald A. Rosenfeld.

Welcome, sir, and you will need to pull that microphone down almost right in front of you. It is not very sensitive.

**STATEMENT OF HON. RONALD A. ROSENFELD, CHAIRMAN,
FEDERAL HOUSING FINANCE BOARD**

Mr. ROSENFELD. Thank you, Chairman Baker, Ranking Member Kanjorski and members of the subcommittee. Today represents my first appearance before this subcommittee. I am honored to appear before you and to thank you for the opportunity to discuss the Federal Home Loan Bank System and reform of the government-sponsored enterprises.

The opportunity to serve at the Finance Board is a great privilege. It has also been my privilege to work in the public sector at both the state and federal levels and most recently as president of Ginnie Mae. I have also spent a good part of my career in the real estate development and investment banking businesses.

As chairman of the Finance Board, I testify today as a regulator who is committed to ensuring that the banks operate in a financially safe and sound manner, and carry out their housing finance mission.

Mr. Chairman, I would like to begin by providing this subcommittee with an update on the banks' registration with the SEC. The banks are required to file registration statements by no later than June 30, 2005 and to have their registrations effective by no later than August 29, 2005. The Finance Board staff has been working with the banks to ensure that registration is accomplished in a smooth and efficient manner.

Over the past year, the Finance Board issued three advisory bulletins to the banks to help guide them through the registration process. To date, 11 of the banks have filed draft Form 10s with the SEC, and 10 of those banks have received comment letters from the SEC.

On the supervisory front, last year, the Finance Board entered into two supervisory written agreements: One with the Federal Home Loan bank of Chicago and the other with the Federal Home Loan bank of Seattle. Under the written agreement, the Finance Board required the Seattle bank to hire independent third parties to conduct reviews of the board and management oversight and the bank's risk management processes. Those reviews are under way.

In considering its strategic alternative, the bank's board of directors and senior management have decided to focus on the company's traditional mission assets, called advances. This will likely include the development of an exit strategy for the Mortgage Purchase Program, which will enable the banks to lower its overall risk profile and reduce its operating cost structure.

Previously, in June of 2004, the Finance Board entered into a written agreement with the Federal Home Loan bank of Chicago. Last month, the Finance Board accepted the bank's 3-year business and capital plan.

At the Finance Board, we are continuing to assess the performance and condition of these banks, and I can assure you that we

will take whatever additional measures, if any, are needed to maintain the safety and soundness of each of the Federal Home Loan Banks and the system as a whole.

Now, let me summarize briefly four key supervisory initiatives and priorities for 2005 and offer a brief comment on GSE reform. First, as noted, interest rate risk monitoring is at the top of our supervisory agenda. Interest rate risk is an inherent and significant risk facing the banks due to the nature of their business.

Second, this year we initiated a program to visit each bank on a quarterly basis, between our annual on-site examinations. The visits give us an opportunity to follow up on examination issues and other developments.

Third, we have directed our examiners to place increased emphasis on two essential elements of sound banking: Corporate governance and risk management. In addition, our examiners will continue to give close scrutiny to the accounting practices.

And fourth, we intend to provide additional guidance with respect to the Affordable Housing Program.

Finally, regarding the reform of the housing GSEs, there can be little debate over the need to have the very best supervision and regulation. On that, I suspect we can all agree. So, the issue comes down to whether there will be real GSE reform.

Real GSE reform consists of equipping the regulator with the powers that are most critical to providing effective and thorough oversight. In my view, a regulator must have a complete arsenal of enforcement powers, including, but not limited to, freedom from the appropriations process, the authority to approve new business activities and receivership authority. As for the structure of the regulator, the administration has spoken in its 2006 budget, and there seems to be a clear consensus in favor of supporting the notion of one regulator.

Chairman Baker, Ranking Member Kanjorski, and members of the subcommittee, thank you for this opportunity, and I am pleased to answer your questions.

[The prepared statement of Hon. Ronald A. Rosenfeld can be found on page 89 in the appendix.]

Chairman BAKER. Thank you very much, Mr. Chairman. I want to start with just a general observation and maybe a comment from you.

Your authorities at the Finance Board in relation to those of the current Fannie and Freddie regulator, OFHEO, you can remove a bank officer or a director, place a bank into receivership, the ability unilaterally to address capital levels, even perhaps limit portfolio growth in a particular product or activity. Do you view those tools as essential to a regulator overseeing GSE activity?

Mr. ROSENFELD. Chairman Baker, I believe that those tools are absolutely essential to effective regulation, and I would add that one of the reasons that I believe we at the Housing Finance Board have been and will continue to be a very effective regulator is the fact that we do have that complete arsenal of tools at our disposal.

Chairman BAKER. So you would then, I presume, make the observation that if a single regulator is to be created, the regulator created for this new purpose should at least have the authorities cur-

rently in the Federal Housing Finance Board and not the diminished powers granted currently to OFHEO.

Mr. ROSENFELD. I certainly agree with you. Quite frankly, I am not sure whether in the list of powers that you articulated that you mentioned being free from the appropriation process. If you had not, that also is a very critical aspect. But I would concur with your statement.

Chairman BAKER. With that addendum, certainly, I agree.

There is one other point, which I think has not been discussed at great length. In questioning to Mr. Greenspan several weeks ago, I was concerned about the rate of growth at Fannie and Freddie, and we segued into the question of securitization. In your testimony, you made note of the fact the bank system does not securitize.

It was in the early to mid-1990s Mr. Brendsel, then CEO of Freddie Mac, at that table, when asked by me about the advisability of then the growing MBS portfolio, as to the advisability in engaging in that practice, and at that time his view was, "That is enabling us to move certain business risks off our books to the market, and we look at it as a security device, enabling us to generate even more liquidity."

At the same time, he said in that day, "We would not conceive of repurchasing our own MBS back onto the books for the sake of enhanced profitability." And of course that view appears to have changed significantly over time.

If the bank system were to securitize and to issue MBS but be prohibited from repurchasing its own MBS, as a regulator, do you see that as an ill-advised path or have you given any consideration at this point?

Mr. ROSENFELD. I think that that is certainly one option, and I think in order to answer the question let's stipulate that a decision as to the ability to securitize has been made. I am not addressing the advisability of that, but we will stipulate that that is the case.

I think if that is the case, we essentially have three options. One option is basically the Ginnie Mae model where Ginnie Mae provides a guarantee, collects a fee and goes home. That is all it does. The next model would be something which I think perhaps might be described as a variation of Alan Greenspan's comments where the GSEs could purchase securities, their own included, but have a limitation on how much of those securities they can buy. And I suppose a third model would be essentially what we have now, at least in the case of Fannie and Freddie, where they purchase their own securities without a limit.

Those are very important decisions, and, quite frankly, I think that the decision of which one of those three models is most appropriate is best left to the Congress.

Chairman BAKER. And one other observation in my discussion with Mr. Frank about the limitation on portfolio growth, if we were to assess some arbitrary percentage against the earnings of that portfolio at the other two GSEs, similar to the Affordable Housing Program, my concern would be without a cap that would only fuel more growth as the entity attempts to offset the loss of that percentage with additional revenue to inure to the benefit of share-

holders and a perverse incentive to see that portfolio's growth rate even escalate unless there is some sort of cap.

Chairman Greenspan did indicate in his comments that the current \$1.6 trillion worth of portfolio holdings for both Fannie and Freddie do not have any nexus to facilitating home ownership. That being the case, if we do adopt some cap in light of their rate of growth, would you as a regulator feel that that cap is also appropriate for the bank system or would you feel as a regulator that that cap would also be appropriate for the bank system going forward?

Mr. ROSENFELD. Well, certainly, that cap was not necessarily appropriate for—and I do not know what it would be, but it is not necessarily appropriate for the home loan banks. The notion of a cap, as such, to the extent that the Congress deems it appropriate, I think if it is applicable to Fannie and Freddie, would have a logical nexus to the home loan banks.

I think in regard to your observation, and in response to Congressman Frank's thoughts, I think that imposing additional tax might encourage an expanded portfolio. I think that is possible, but I think you have to keep in mind some fundamental differences between Fannie and Freddie and the home loan banks, one of which is that Fannie and Freddie are publicly held companies. Earnings per share are a very significant part of their interest. While there is an interest on the part of the home loan banks to earn profits, they simply do not have in the system the kinds of motivations in terms of earnings that exist with a publicly held company.

Chairman BAKER. Thank you. I certainly have come to recently appreciate how earnings per share affect a lot of things over at Fannie.

Mr. Kanjorski?

Mr. KANJORSKI. Thank you, Mr. Chairman.

Mr. Rosenfeld, just to keep the record straight, your opinion as to the safety and soundness of the system at this point in time, is there any reason for the Congress to be overly nervous about any of the Federal Home Loan Banks?

Mr. ROSENFELD. No, sir.

Mr. KANJORSKI. And would you say that as a result, even through some tough times in terms of a recession, they have come through rather well, but they have had to have corrective mechanisms put into place under the direction of the bank?

Mr. ROSENFELD. Congressman, I believe that the safety and soundness of the home loan banks are well assured. I think the activities are in good hands, and I will tell you that as chairman of the Housing Finance Board, we are cognitive of our primary responsibility, which in fact is safety and soundness, and we intend to do what needs to be done.

Mr. KANJORSKI. Well, I think there is a discussion, certainly, with myself and some of my other colleagues in terms of whether or not there should be one single regulator for Fannie Mae and Freddie Mac and the Federal Home Loan Banks. You have an opinion we should have a single regulator or are you somewhat similar to my thinking that the Federal Home Loan Banks are rather unique institutions doing rather unique things vis-a-vis Freddie Mac and Fannie Mae and therefore special understanding of the

banks and their relationship to their stockholders, other banks, national banks, et cetera, demands a little bit more hands-on understanding of that difference?

Mr. ROSENFELD. I think, Congressman, there are a number of issues that would end that question that I think I need to address. Number one, whatever is done from this day forth I think it is important that we recognize and the Congress recognizes the difference between Fannie and Freddie and the home loan bank system. As I said earlier, Fannie and Freddie are publicly held corporations, whereas the home loan bank system is a cooperative. There are a whole series of significant aspects that differentiate the two. Those differences must be respected.

Today, the Federal Housing Finance Board is I think an extremely capable regulator for two reasons: Number one, we have very good people, and, number two, we have powers that Chairman Baker articulated. So between the people and the powers we, I think, are in an excellent position.

If in fact it was determined by the Congress to go through with one regulator, assuming that the powers remain, we would not at all be impaired. But I would point out to you that—and there might be a certain amount of marginal benefit that we might pick up by some consolidation under one regulator. But even if we do not go to one regulator, I would assure you that as to the Federal Home Loan Banks they will continue to be very well regulated.

I am not adverse to the one regulator. I think, as I said earlier, it is up to the Congress, and regardless of which way it goes, we will do what we need to do in a very appropriate way at the Housing Finance Board.

Mr. KANJORSKI. While we are on that subject, I know you are just newly on board, but we have had some discussions ourselves on economic development and the use of the Federal Home Loan Banks as a tool toward probably bringing more money into the area and having it operate through a better filter system, local banks that utilize the lending services of the Federal Home Loan Bank System.

Have you had the occasion to examine some of the tools that are down at the Finance Board to see whether or not we need a greater expandability to encourage more activity in the area of economic development and community development?

Mr. ROSENFELD. I think, Congressman, we have the tools. The problem in that situation, which I share your views in this very important matter, the problems are really, I think, twofold. One is we have to, in effect, educate the bankers in the home loan bank system as to the desirability of making loans in those areas. The other, which perhaps is even more important, is we have to create a demand amongst borrowers for those kinds of loans.

And I think at the end of the day the real challenge is to bring both sides together. We want to have bankers who are more receptive to making those kinds of loans, and we want to have more people asking for those kinds of loans. And I think at that point we will have some real success. But unless we do both, I think it will be very difficult to really make a meaningful contribution to what I know we want to contribute to.

Mr. KANJORSKI. Thank you very much, Mr. Chairman.

Chairman BAKER. I thank the gentleman.

Mr. Barrett?

Mr. BARRETT. Thank you, Mr. Chairman.

Chairman Rosenfeld, thank you for being here today. It was great to talk to you the other day. Appreciate you taking some time with me.

As you know, Chairman Oxley and Chairman Baker have been leaders on the issue of corporate governance, and because of that, a lot of committee members have questions regarding the current vacancies on appointed director positions at the Federal Home Loan Banks, and I am going to roll about four questions into one, so if you could help me out here.

Currently, what is the status of the appointed director positions on the Federal Home Loan Banks boards? What options are being considered? What is the current plan and the course of action to fill these vacancies? And if you can give me some type of time frame, too, Mr. Chairman, I would greatly appreciate that.

Mr. ROSENFELD. Congressman, people who I refer to as public interest directors are very important to the home loan bank system. Quite frankly, the historic way of selecting directors is probably inappropriate in the world that we live in today with the growth of the banks and the sophistication of the banks. I think historically selection for public interest directors tended to be in the nature of a thank you, an honorarium, a reward, something of that nature. In today's world, that is simply inappropriate. These are very large, very complex institutions.

And the challenge we have is to create a process that brings directors, public interest directors to the table who have the requisite knowledge and qualifications that are appropriate for the positions that they are filling. That is not easy to do for a variety of reasons, one of which is you have to define, based on every particular bank, what are there particular needs. They may have some very, very capable people and what you need in Cincinnati you do not necessarily need in Topeka. So one problem is, what do they need based on their particular situation?

Another problem is currently there is a cap, a relatively modest cap for service on these boards, and I think that, quite frankly, although it is currently our statutory obligation to do so in terms of appointing directors, the Congress has looked at this and is considering at least in the Hagel bill that I have seen a couple of changes which I think are good. Number one, the selection of public interest directors would be made by the banks. Number two, the salary cap would be off. Number three, the terms would be extended from 3 to 4 years, all of which I think are good.

Now, I would point out we are not waiting—we cannot wait until Congress acts, but we are looking at how we can go about really creating a board that is appropriate for what is needed in the system today.

And let me also add, the term, “public interest directors,” is I think in some respects used in the wrong way. Now, in the statute it is mentioned the public interest directors, which have something of a descriptive nature to them in terms of their background and qualifications. What I really think we are talking about here is out-

side directors. Within a subset of outside directors are public interest directors.

But I think virtually all students of corporate governance would agree that a totally inside board is not effective. We would hardly concur with that. I think most students of corporate governance would agree that the regulator should not appoint the regulated, but that is where we are.

As I said a moment ago, we are working on it. It is not easy in terms of time to get it done. I really cannot give you a definitive date, but I would certainly hope that it does not go on many more months.

Mr. BARRETT. So short of legislation, I mean, there is no definitive plan, as we stand right now?

Mr. ROSENFELD. We have not evolved to the point where saying that if you do not pass legislation we will do A, B, C, D. We have not gotten there yet.

Mr. BARRETT. Okay. But you think you are getting closer?

Mr. ROSENFELD. We are working on it.

Mr. BARRETT. Okay. One last follow-up. And I understand where you are coming from that public interest directors, I mean, it is a different environment, it is a different world, but if we get the right person for the right job, you still believe that there is a place for public interest directors, Mr. Chairman?

Mr. ROSENFELD. As a subset of outside directors. I think they are part of being an outside director. So the answer to your question is, yes.

Mr. BARRETT. Thank you, Mr. Chairman.

Thank you, Mr. Chairman.

Chairman BAKER. I thank the gentleman.

Ms. Wasserman Schultz?

Ms. WASSERMAN SCHULTZ. Thank you, Mr. Chairman.

Mr. Rosenfeld, just to follow up on the question that the gentleman was just asking you, you originally extended the terms of the public interest directors by 6 months and then that was pulled back. Can you elaborate on why you initially felt that that was why and then subsequently that was not the direction that you went in?

Mr. ROSENFELD. Yes, Congresswoman Wasserman Schultz. We had originally sought to hold over existing directors whose terms were expiring. We did that because we felt, as I think many of you feel, that a full complement of directors is desirable. In particular, I believe that of those directors whose terms were expiring, something like nine of them were either chairman or vice chairman of their boards, which are obviously positions of significance. We felt that if we were able to hold them over pending a clarification of what is really needed, that would be desirable.

It was subsequently determined by the Justice Department, conveyed to White House counsel, that what we did was not within our legal authority, and having learned that, we rescinded the extension, and that is exactly what happened.

Ms. WASSERMAN SCHULTZ. In the past when those openings occurred, how had that been handled? When an opening occurs, was there an automatic reappointment or was there a—

Mr. ROSENFELD. Congresswoman, I honestly do not know, not having been there. I know that in the short time I had been there,

when I acted, there was an awful lot of letters that came in terms of people supporting one candidate or another, but I really do not know whether people were normally reappointed or not. I simply do not know.

Ms. WASSERMAN SCHULTZ. How could it possibly be better public policy to leave those positions vacant for as long as they have been than to at least extend the terms of the—

Mr. ROSENFELD. But we could not extend the terms. The Justice Department came down and said we do not have the authority to extend the terms. I think what we did was preferable to reappointing somebody for what is a 3-year term and basically continue a process that we think is inappropriate for the governance of these banks.

Ms. WASSERMAN SCHULTZ. But, essentially, now what the situation is, is that you have a very large ship without a captain.

Mr. ROSENFELD. Well, you have a great many captains, a great many directors who remain in office, and I think that in most all the banks, the ones I have spoken to, and I think I have spoken to most, yes, it is true that many of the banks lost very talented directors, but many, many talented directors remain. So this is not a rudderless ship, let me assure you.

First of all, all the member directors are still there, and I believe probably around two-thirds of the appointed directors are still there. So it is not without leadership.

Ms. WASSERMAN SCHULTZ. But it appears obvious, though, that politics has been injected into the way that this is being handled this time as opposed to the previous instances where there were vacancies, and what I would like—if you do not know the answer to the question which I asked you, which was how has it been handled before, if you could have someone find out for me, because I am quite certain that the length of time that they have been left open has not been similar in the recent past. So if you could find out and have someone let me know, I would appreciate it.

Mr. ROSENFELD. We will do so. Thank you.

Ms. WASSERMAN SCHULTZ. Thank you.

Chairman BAKER. The gentlelady's time has expired.

Mr. Fitzpatrick?

Mr. FITZPATRICK. Thank you, Chairman Baker. I just have one question.

Chairman Rosenfeld, by the way, thank you for your testimony. I found this very useful and very helpful.

It was reported, I guess as a result of your filings for 2003, that the federal home loan bank had outstanding debt obligation of about \$774 billion. Can you let us know, let the committee know how much of that debt was held by the United States versus foreign nations and also how much was held governmentally versus by private investors?

Mr. ROSENFELD. Congressman, I do not know the answer to that question. We will have to get back to you.

Mr. FITZPATRICK. Appreciate that. Thank you.

Chairman BAKER. Thank the gentleman.

Mr. Watt?

Mr. WATT. Thank you, Mr. Chairman, and thank you, Mr. Rosenfeld for being here.

Let me just ask a couple of questions about your testimony. Last year, year before last, a number of federal home loan bank officials started approaching me about their interest in more aggressively doing things that were similar to what Freddie and Fannie were doing. And when I investigated further and talked further there seemed to be a substantial division between the member banks about whether that was a good idea. And what initially had appeared to be a federal home loan bank position turned out to be the position of one or two of the member banks, not the whole system.

I take it from your testimony on page two that some of the bank went more aggressively in the direction of doing the same kinds of things that Freddie and Fannie were doing. Is that what the Mortgage Purchase Program was, a reflection of that, or am I missing something here?

Mr. ROSENFELD. In a very general sense, I would answer yes, but it is only partially similar to what Fannie Mae has done.

Mr. WATT. I know I am——

Mr. ROSENFELD. They are different in some very significant ways.

Mr. WATT.—oversimplifying this to some extent, but does the comment, the last sentence at the bottom of page two of your testimony, "This will likely include the development of an exit strategy for the Mortgage Purchase Program," is that a reflection that a decision basically has been made to go back to a more traditional approach and portfolio of activities by the home loan banks than the attitude that seemed to be floating around 2 or 3 years ago?

Mr. ROSENFELD. Congressman Watt, that is an excellent question, and the answer is that that is a decision by the board of the Seattle Bank. That is not a decision of the Federal Housing Finance Board; we have not made that decision. And, quite frankly, I think that the decision that what the other 11 banks do in the system are going to be up to the directors of those institutions. That is clearly a significant decision for Seattle, but it applies only to Seattle.

Mr. WATT. And to what extent are the other banks kind of out there doing those kinds of things similar to a Mortgage Purchase Program?

Mr. ROSENFELD. Well, the biggest participant in that general type of activity is the Home Loan Bank of Chicago, which is substantially more involved in it than Seattle was. I think it is three or four times larger in terms of the size of the program.

A number of the other banks are involved in that program on something of a lesser basis than Seattle, and there are a couple of banks who are not involved in it at all.

Mr. WATT. And has Chicago had more success with it than Seattle? I mean, have they exposed themselves to the same kind of problems?

Mr. ROSENFELD. Well, in the context of both being under a written regulatory agreement, they have both had problems, but I think that it is fair to say in deference to Chicago that the extent of the economic reality of their participation has been more successful than Seattle has been.

Mr. WATT. They made better business decisions——

Mr. ROSENFELD. To date. To date.

Mr. WATT.—and management decisions than Seattle.

Mr. ROSENFELD. To date. But, again, I would emphasize that both are under regulatory agreements.

Mr. WATT. Okay.

Mr. ROSENFELD. Which is not where you want to be if you are in the banking business.

Mr. WATT. All right. What is the Finance Board's attitude toward—or maybe—I am new to this subcommittee, so I am kind of feeling my way.

Mr. ROSENFELD. I am new to the Finance Board.

Mr. WATT. Well, then we may be like the blind leading the blind, as they say.

Chairman BAKER. That will be the gentleman's last question, because his time is getting—

Mr. WATT. I am just trying to figure out whether the Finance Board has a general attitude about whether it is desirable to be in Mortgage Purchase Programs, such as Chicago and Seattle have been involved in, or is there a position that the Finance Board has taken?

Mr. ROSENFELD. Our position, Congressman Watt, is that we are safety and soundness regulators. That is our number one priority. We also want to ensure that the banks operate within their mission of providing housing finance and community investment needs. We have not made nor perhaps will not make a definitive judgment as to the mortgage programs.

I think that we look at them from the perspective of safety and soundness, and to the extent that their activities jeopardize safety and soundness, we will act accordingly. And that is really the framework in which we look at these things. We do not look in a theological or philosophical sense.

Mr. WATT. Thank you, Mr. Chairman.

Chairman BAKER. Gentleman's time has expired.

Mr. Davis?

Mr. DAVIS OF KENTUCKY. Thank you, Mr. Chairman.

As the federal home loan bank is adapting to changes in the marketplace as the economy continues to transform, I was wondering if you are looking at new products or processes to address risk and also give your clients and your members more options.

To that end, I was wondering if you might comment on the discussion about the ability to securitize mortgages, which has been proposed as a way to reduce interest risks at the banks? And in your opinion, do you believe that the banks should be allowed to issue or guarantee mortgage-backed securities in a capital market that are conforming mortgages owned by the banks or their members?

Mr. ROSENFELD. I think, Congressman, it is important that in answering that question we define what securitization means, and let me define what I believe it means, at least in the context of my answer. I believe it means the issuing of mortgage-backed securities by a federal home loan bank which carries the joint and several liability of the Federal Home Loan Bank System. Such a development would represent a significant departure from the current structure and practices of the home loan bank. That departure is

so significant, in our judgment, that it should only be undertaken at the direction of the Congress.

I am sorry, was there another—

Mr. DAVIS OF KENTUCKY. No. So from that perspective, you are against that.

Mr. ROSENFELD. No, I am not against it. What I said is that the decision to securitize, in the context I defined it, should be left to the Congress. That is a very different activity than historically has been performed by the home loan banks.

Mr. DAVIS OF KENTUCKY. Would your personal view be to keep it in the more traditional vein where it has been as opposed to where Fannie Mae has gone?

Mr. ROSENFELD. Congressman, I really do defer to the Congress. I do not have a strong personal opinion.

Mr. DAVIS OF KENTUCKY. Okay. Thank you, Mr. Chairman.

Chairman BAKER. I thank the gentleman.

Ms. Velazquez?

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

Chairman Rosenfeld, it is my understanding that the current Affordable Housing Program the board oversee subsidizes the cost of housing for low-income, owner-occupied and rental housing. With regards to rental housing specifically, Affordable Housing Program subsidies support housing in which at least 20 percent of units will be affordable for very low-income households at or below 50 percent of the area median income.

Given that there is a shortage of affordable rental housing, some communities, like those in my district, are exploring opportunities to set aside a small chunk, 30 or 40 percent of units, for low-income families in order to meet the demand for housing.

What are your thoughts on the banks reaching more families by increasing the Affordable Housing Program to 30 or 40 percent of units and serving poorer families by lowering the area median income maximum to 40 or 30 percent?

Mr. ROSENFELD. Congresswoman, I am afraid I must answer you in a generality, because I simply do not have the knowledge or facts to answer you specifically as to the questions you are asking me. As a general proposition, we would certainly like to see the Affordable Housing Program expanded to help those people who need it.

Given the reality that when you give more to one group you take from another because the total is fixed, I think part of our challenge, and for that matter part of your challenge, is to make those very tough calls as to what we do. I will try to get back to you on the specifics and perhaps lay out some of the issues involved in what you are suggesting, but, unfortunately, I just cannot respond to you today.

Ms. VELAZQUEZ. Well, I would appreciate if you sent to us a written response. But at some point or another, we need to look at the crisis that we are facing in this country, especially in urban centers, including rural America regarding affordable housing.

Mr. ROSENFELD. I agree.

Ms. VELAZQUEZ. Chairman, the issue of limiting Federal Home Loan Banks' members' use of advances has come up in the recent debate about whether to include the banks in GSE reform. It is my

understanding to advances to members is a significant part of the banks' business. Can you comment on the potential effects of limiting the use of advances by federal home loan bank members?

Mr. ROSENFELD. I am not aware of any discussion about limiting advances by the home loan banks, unless I—

Ms. VELAZQUEZ. This is an issue that has been raised by some of your lenders, including the ones from New York.

Mr. ROSENFELD. Congresswoman, I have not heard about limiting advances.

Ms. VELAZQUEZ. Okay. Thank you very much.

Chairman BAKER. I thank the gentlelady.

Mr. Feeney?

Mr. FEENEY. Thank you, Mr. Chairman, and thank you, Mr. Rosenfeld.

You talked a lot about supervision and oversight and regulation. I am interested in the capital structure of the home loan banks and your oversight of it. Gramm-Leach-Bliley mandated that the capital structure be changed for these banks. What is the status of the banks' implementation of these new capital plans, and what is the average percentage leverage of capital in the relative amount of 6-month and 5-year maturity stock in the system, to your knowledge?

Mr. ROSENFELD. To my knowledge, 10 of the 12 banks have completed their capital plans under Gramm-Leach-Bliley. I am sorry, I did not hear the rest of your—

Mr. FEENEY. What is the average percentage of leverage capital in the amount of 6-month and 5-year maturity stock in the system, if you know?

Mr. ROSENFELD. Well, the minimum leverage capital is, I believe, 4 percent. Some banks have higher. I cannot tell you the average. I certainly will get back to you on that.

Mr. FEENEY. Okay. I think that would be helpful. And which two banks have not yet fully implemented the capital plan?

Mr. ROSENFELD. I am going to have to get back to you on that, sir.

Mr. FEENEY. Okay. In 2003, the Federal Home Loan Banks had about \$775 billion worth of outstanding debt. Do you know how much is held by U.S. as opposed to foreign investors of that debt?

Mr. ROSENFELD. That question was asked a few moments ago. I did not know it then, and I still do not know.

Mr. FEENEY. All right. Okay. Sorry, I was out of the room for a minute.

Mr. ROSENFELD. I understand.

Mr. FEENEY. But I am interested in the capital structure, and if you can answer those questions for us, I would be grateful.

Mr. ROSENFELD. We will, sir. Thank you.

Mr. FEENEY. With that, I will yield back the balance of my time. Thank you, Mr. Chairman.

Chairman BAKER. I thank the gentleman.

Mr. Meeks?

Mr. MEEKS. Thank you, Mr. Chairman.

Mr. Chairman, I am going to try to get some clarification. I know as of last June the FHFBS decided to require the FHLBs to register a class of equity securities under the 1934 act. And I have no problem with greater protection of our financial system, but I am not

clear on what the benefits are. The FHLBs issued debt securities, and they are not owned by the public but by their members, and so I was wondering if you could explain to me more clearly the benefit of having them register and whether or not the member banks are not receiving enough information on their own FHLBs that they own?

Mr. ROSENFELD. Congressman, I think that there are a couple of benefits to registration with the SEC, although I certainly will acknowledge that I was not there when the debate took place. But the home loan bank system is a very significant issues of debt, and I believe that the public is better served by complete openness and candor in terms of the status of organizations that issue debt, publicly held debt. And I think in today's world greater disclosure, given a choice, is clearly the way to go.

Another factor, another benefit that I think is prevalent—or present, I should say, is the fact that the disciplines involved in registering with the SEC tend to provide for better management of an organization. I have spent most of my life, quite frankly, in the private sector, partially in a family owned business, partially with a public company. I will tell you that being part of a public company is much more onerous, it is much more difficult and challenging and aggravating in terms of the registration requirements. But it also makes you a better company because it forces you to do things that you might not do if you were not required to do it.

Mr. MEEKS. I am trying to also conceptualize in my head and ensure that the separate legal and operational characteristics of the Federal Home Loan Banks are maintained and not lost in an agency that would also regulate the other two much larger GSEs. I think that is important.

Now, the question then comes in, the day-to-day decisions, the everyday supervisory decisions between the deputy director as opposed to the director will do. Would the director be established as more of an agency administrator who will review the actions of the deputy director who may then focus in more on and interpret some of the regulatory decisions that are affecting the GSEs? How do you see that? How do you see that we can make sure we maintain the differences between the Federal Home Loan Banks and Fannie and Freddie Mac?

Mr. ROSENFELD. Well, I think everybody who is knowledgeable acknowledges the fact that Fannie and Freddie and the home loan banks are very different.

Mr. MEEKS. I see.

Mr. ROSENFELD. I have no idea how this is going to turn out and what the ultimate structure is going to be or who is going to be in what position, but I have to believe that anybody who would come into a position of responsibility in the oversight of the home loan banks would very quickly learn that the system is not broke and if it ain't broke, do not fix it, because it does not need to be fixed. And I simply cannot imagine that people would come in and try to materially change what is fundamentally a very, very well run, well disciplined safety and soundness regulator. So, quite frankly, I am really not terribly concerned about that.

Mr. MEEKS. Thank you.

Yield back, Mr. Chairman.

Chairman BAKER. Mr. Royce?

Mr. ROYCE. Thank you. Thank you, Mr. Chairman.

And, Chairman Rosenfeld, I would like to preface my questions by giving the following safe harbor, and that is I do not believe the Federal Home Loan Bank System is on the brink of failure, but as this committee considers legislation, we need to prepare for all scenarios.

And so my first question, I want to get your thoughts about receivership in the Federal Home Loan Bank System. Currently, the 12 banks are jointly and severally liable for the senior debt obligations of each bank. Those bonds carry triple A ratings. This means that if one bank were to default on its bond payments, the bond holder would be made whole by the other 11 banks, correct?

Mr. ROSENFELD. Correct.

Mr. ROYCE. However, the individual banks also enter into derivatives contracts with counterparties to hedge interest rate risk. Not all individual banks have triple A counterparty ratings. In the event of a failure at one of the banks, how would counterparty contracts be handled? Does joint and several liability apply to derivatives contracts in these cases?

Mr. ROSENFELD. It is my understanding that they do not.

Mr. ROYCE. They do not. Well, the Federal Home Loan Bank System is in a very unique situation, because we have got 12 member banks with close to \$1 trillion in assets. You are convinced that the argument of joint and several liability does not make one bank liable for the actions of the other 11 banks in some instances but it does in others. But better regulation and SEC registration help to protect the system. Do you believe that the 12 banks should be required to share more detailed information with one another as an additional protection to the system, given the joint and several liability argument?

Mr. ROSENFELD. Congressman, I believe that the 12 banks should be given the option of sharing more information with each other. I am hesitant to use the word, "require," because you can perhaps get into areas that it may be inappropriate to share. And I think, quite frankly, we are headed in that direction. I know our general counsel has been meeting with the general counsel of the various home loan banks exploring mechanisms for the sharing of information. I think that the fundamental track that your question is on I think is a very important one.

Mr. ROYCE. Don't you think it would guarantee some measure of additional protection if that information were shared?

Mr. ROSENFELD. I agree with you that if more information was shared, that would provide some greater degree of protection.

Mr. ROYCE. And as you say, internally they are working on a methodology to encourage sharing, although not mandated; is that—

Mr. ROSENFELD. That is correct.

Mr. ROYCE.—your understanding?

Mr. ROSENFELD. That is correct.

Mr. ROYCE. If it were mandated, do you think there would be even further protection to the overall system?

Mr. ROSENFELD. I think it depends on what is mandated. I think that if you—I suppose you could go so far as to require things that

would actually jeopardize the system, but that is why I think a voluntary approach is—and the human pressures that come from that kind of environment I think would probably do the trick.

Mr. ROYCE. Chairman Rosenfeld, thank you very much.

Chairman BAKER. Thank the gentleman.

Mr. Davis?

Mr. DAVIS OF ALABAMA. Thank you, Mr. Chairman.

Chairman Rosenfeld, good afternoon to you. Let me pick up, if I can, on the questions that Mr. Watt was raising to you earlier. One of the things that was interesting to me as I listened to your colloquy with him you were talking about the evaluation the Finance Board will make as to whether home loan banks should move into the secondary market. You talked about the fact that you all have not reached a decision or a consensus yet as a board on whether or not that is an advisable course for home loan banks.

I want to ask you about that, but what was interesting about that colloquy to me is that it raises an interesting contrast I want to get your reaction to. As you know, we are, as a Congress, and this committee in particular, very much considering the new regulatory structure, not just for the home loan banks, potentially, but for the other GSEs. Fannie and Freddie, and one of the points of contention has been whether or not new programs or new activities, even, should be given a high level of scrutiny and be subjected to advanced approval by a regulator.

Now, if I am understanding your testimony correctly, the Finance Board does not require advanced approval of whether or not a bank goes into the secondary market. If a bank makes a decision to do that, it can do that; is that correct?

Mr. ROSENFELD. If you mean we have to approve the selling of assets in the normal course of the business, the answer is no.

Mr. DAVIS OF ALABAMA. And, again, I understand that whether or not it is a good practice for home loan banks to move into a secondary market, I understand that is under evaluation, but what is interesting to me is that under a regulatory structure that you just said has worked very well, and I agree with you, it has worked very well, the Finance Board does not require that kind of advanced approval of home loan banks, but yet there are some members of the committee who do believe that there ought to be a high level of review for new programs or activities on the part of Fannie or Freddie. Does that strike you as a contradiction?

Mr. ROSENFELD. No, not really. I think that, again, Fannie and Freddie is really not on my plate.

Mr. DAVIS OF ALABAMA. But you do take my point that obviously new programs and new activities requiring a level of advanced scrutiny of that seems fairly intrusive, and it raises the question to me is shouldn't we learn something from the home loan banks? Obviously, the home loan bank does not appear to be nearly as intrusive in terms of what it inspects regarding its member banks, and it seems to work very well, doesn't it?

Mr. ROSENFELD. I think we are intrusive where intrusion makes sense.

Mr. DAVIS OF ALABAMA. But you have not found an intrusion makes sense in the context of advanced regiments by secondary mortgage. So, again, I am not trying to debate you on the subject,

I am just trying to get a general reaction. That, to someone who is a layman—I have included myself in that category—seems like something of a contradiction. If it has worked well for the Federal Home Loan Banks to allow the home loan banks to make as basic a decision as whether to go into the secondary market, maybe that tells us something about whether or not it is exactly necessary or healthy.

Mr. ROSENFELD. Congressman, let me be very clear, and perhaps I misstated a moment ago: In terms of selling loans in the secondary market, that would require our approval. I was addressing the issue of just generally buying and selling assets, which they do every day. But in terms of selling mortgages in the secondary market would require our approval.

Mr. DAVIS OF ALABAMA. Okay. But what about the specific chorus of whether or not home loan banks ought to be engaging in that practice, as a general rule, what Mr. Watt was asking you about earlier? Is there a consensus on the Finance Board that that it is a good or bad practice for member banks to be entering the secondary market?

Mr. ROSENFELD. I think you have to look at the particular situation. Let me leave aside the issue of securitization, which is a whole other category, as I tried to define it earlier. But the mere act of selling mortgages into a secondary market may or may not be appropriate. It depends upon the circumstances of that bank and what—

Mr. DAVIS OF ALABAMA. And that is a decision the bank would make.

Mr. ROSENFELD. Subject to our approval.

Mr. DAVIS OF ALABAMA. Okay. Subject to your approval.

Mr. ROSENFELD. Right. I am sorry, going back to Fannie and Freddie.

Mr. DAVIS OF ALABAMA. Well, I was just trying to make a basic comparison, one of the major points of controversy around Fannie and Freddie is whether or not when they engaged in new activity or new programs there ought be a level of advanced scrutiny by the regulator, whoever the regulator turns out to be. And what I am simply trying to do is to ask you whether or not there is a difference or whether there is an appropriate difference between your regulatory authority and the level of regulatory authority that is being proposed for Fannie and Freddie?

Mr. ROSENFELD. Well, I think that Fannie and Freddie exist pursuant to essentially a contract and a charter, and I think that they have been given certain benefits in exchange for certain restraints, limits as to what they could do, and I think it is appropriate that whatever they are undertaking be viewed in the context of the contract that they entered into.

I think in the case of the home loan banks I think there is an element of that, but I think we are in a somewhat different situation.

Mr. DAVIS OF ALABAMA. I think my time has expired, Mr. Chairman.

Chairman BAKER. The gentleman's time has expired.

Mr. Scott?

Mr. SCOTT. Yes. Thank you, Chairman Baker.

Chairman Rosenfeld, let me ask you a few questions about safety and soundness, which, as I understand it, is one of your primary responsibilities that you are charged with ensuring that each of the 12 Federal Home Loan Banks operate in a safe and sound manner.

What is the status of the comprehensive accounting review of the banks, and are there any preliminary findings that you could share with this committee?

Mr. ROSENFELD. First of all, Congressman, let me tell you that, in effect, there are two important activities going on, one of which, of course, as I mentioned on a number of occasions, the SEC registration. That is moving along in a very quick fashion, and we intend for the banks to complete their work as scheduled.

We have also said in the past, and we will reiterate, that we want the accounting of these home loan banks to be absolutely appropriate, given the various FASB rules and regulations. And we said that we would do whatever needs to be done to ensure that would occur.

We, to date, quite frankly, have not begun a specific activity in terms of a special accounting review. If in fact we determine as time goes by that the need for that sort of thing is in fact appropriate, I assure you we will do it. And if that becomes in conflict with the SEC registration somehow, we will deal with that when the time occurs.

I would point out to you, however, as we sit here, I am not aware of anything that exists in any of the banks that would suggest that there is an issue that needs to be corrected.

Mr. SCOTT. When the SEC registration process of the home loan banks stops, has there been any problems?

Mr. ROSENFELD. Well, I think there are always problems when people are asked to do something comprehensive and new. So I would describe it as more nits and gnats as opposed to major substantive problems.

Mr. SCOTT. Should, in your opinion, a single financial institution, any single financial institution be permitted to have a relationship with more than one federal home loan bank?

Mr. ROSENFELD. Well, that question is I think most frequently put in the context of, what do you think about multidistrict membership. It is the opinion of our counsel, our general counsel, that we at the Finance Board do not have the authority to authorize multidistrict membership. I suppose one could shop around and get another opinion someplace, but at the end of the day, that, to me, much like securitization, is an issue that goes to the very core of the creation of the home loan bank system and quite frankly should be determined by the Congress.

Mr. SCOTT. Now, should home loan banks be allowed to issue or guarantee mortgage-backed securities by conforming mortgages owned by the Federal Home Loan Banks or their members?

Mr. ROSENFELD. I did not get the last part.

Mr. SCOTT. Should home loan banks be allowed to issue or guarantee mortgage-backed securities by conforming mortgages owned by the Federal Home Loan Banks or any of their institutional members?

Mr. ROSENFELD. I assume, Congressman, you are asking me the question about securitization, unless I am wrong. I mentioned ear-

lier that I think securitization, which would mean the issuance of mortgage-backed securities that are backed by the joint and several liability of the home loan bank system, I think the decision to do that ought to be left to the Congress.

Mr. SCOTT. Thank you.

Chairman BAKER. Thank you, Mr. Scott.

Mr. Miller?

Mr. MILLER OF CALIFORNIA. Thank you, Mr. Chairman.

Currently, the federal home loan bank has a single regulator for both mission oversight and safety and soundness, different than Freddie and Fannie. Freddie, they have one for safety and soundness and the other one for a different mission. What can we learn from FHLBs compared to Freddie and Fannie as it applies to looking to preserve the housing mission while ensuring safety and soundness at the same time?

Mr. ROSENFELD. I am sorry, could you—

Mr. MILLER OF CALIFORNIA. Well, your structure has a single oversight, whereas Freddie and Fannie have a double. Can you compare the two, and what should we look to to preserving the mission of Freddie and Fannie as it applies to housing?

Mr. ROSENFELD. Well, I think that we at the Finance Board have virtually all the requisite powers we need in terms of being a safety and soundness regulator to assure that the banks are operated in a safe and sound way and fulfill their mission.

I think, and, again, I am by no means a student of the OFHEO rules and regulations, but it is fairly apparent that they did not have the same tools that we had. I think the best way to assure that Fannie and Freddie meet their housing mission is to make sure that they are operated in a safe and sound fashion, which means the regulator has to have the right tools. I think if they operate in a safe and sound fashion, I see no reason to believe that their commitment or their mission would not be achieved.

Mr. MILLER OF CALIFORNIA. Can you give me the pros and cons to each approach, all that you see out there, separating regulators versus separating single regulators—the single versus the separate, having two versus one?

Mr. ROSENFELD. Yes. I think that the reasons for doing it, as a practical matter, may be—if that is the route to get appropriate governance over Fannie and Freddie, then that is probably a route you ought to go. That just may be the way to do it. A couple of the advantages of doing that is I think that there would be some enhanced expertise, particularly in the area of which management by having a larger organization. I think there may be some economies of scale in terms of the administration and so on.

I think that in terms of perception, and I am not sure how significant it is, but I think there is an argument that perceptions amongst the investment community would be that both carry the same kind of a quality in terms of their securities as opposed to one being perhaps a stepsister. So those I think are all benefits.

The negatives, quite frankly, are not negatives, in my opinion, providing that whoever is in charge recognizes that Fannie and Freddie and the home loan banks are really quite different and not only recognize it but respects the difference and governs in a manner that is respectful of those conditions. As I said earlier, there

is no question in my mind the Finance Board regulatory structure today is first rate, and if we went to one regulatory, it would continue to be first rate, providing it would be left alone and its talents and skills were respected.

Mr. MILLER OF CALIFORNIA. We are looking at breaking up where HUD has currently had oversight to have two separate ones: One for fiscal oversight and one for programmatic. The problem I am having is when you shift programmatic away from HUD, who I believe has expertise, that I am concerned could create a problem because when you are dealing with programmatic, as you know, many of the programs out there change products from day to day to try to meet the demands of the industry. What do you think about that?

I mean, I think HUD has expertise and they have proven that historically to continue to have oversight of the programmatic side and possibly coming in on the fiscal side with—

Mr. ROSENFELD. I think, Congressman, you have to recognize that HUD as a place does not have expertise. HUD as a place that has people who are experts has expertise.

Mr. MILLER OF CALIFORNIA. Correct.

Mr. ROSENFELD. And I think if you take—

Mr. MILLER OF CALIFORNIA. But you could say Congress does not have expertise, it is the individuals within Congress who have the expertise.

Mr. ROSENFELD. If you take the people who are at HUD or take others who are very knowledgeable and put them in another building, that expertise would be there too.

Mr. MILLER OF CALIFORNIA. But what do you accomplish? All you are doing is creating a name change. That is my concern. If we are going to take the same people that have the ability to continue programmatic oversight, as they have in the past, and you shift people to a different room, yes, I would agree with you, but is that what we are doing? I mean, that is my concern, that we might be shifting authority away from HUD and yet not moving the people who have the oversight capability to move with that.

Mr. ROSENFELD. Congressman, I—

Mr. MILLER OF CALIFORNIA. That is a difficult question.

Mr. ROSENFELD. With all due respect, that part of what is proposed I have simply not considered. It is an interesting question. I do not know the answer.

Mr. MILLER OF CALIFORNIA. Okay. I think my time has expired.

Thank you, Mr. Chairman.

Chairman BAKER. I thank the gentleman.

Mr. Rosenfeld, I just wanted to come back, given the diversity of questions you have responded to this morning, and make some general observations. The Federal Housing Finance Board operates as a unitary regulatory in the sense of safety and soundness and mission compliance. In response to the question the gentleman from Alabama, Mr. Davis, relative to product approval, with regard to MPP and MPF, you had to get prior approval as opposed to HUD who has to stop the practice of Fannie and Freddie once having entered into the market.

In my knowledge of the matter, it has never been brought to my attention where HUD has ever turned down a product of Fannie

or Freddie. I would consider that to be fairly significant evidence that nobody gets it right 100 percent of the time. My wife has pointed that out to me.

The point being that you have broad unilateral authority to act. There is a clear receivership provision. You have the unilateral right to adjust capital, as you deem appropriate in the public interest. You can limit their portfolio growth. All of these matters considered and aggregated has not in any way adversely affected the bank system's ability to enter the capital markets and acquire capital needed for its business purposes. Is that correct?

Mr. ROSENFELD. That is true.

Chairman BAKER. And in fact when we look at your operations, you are subject to a 20 percent net operating profit by district to meet your REFCOR obligations, a 10 percent net profit for affordable housing, so, essentially, one-third of your net operating profits is allocated by government requirements to specific purposes. That does not seem to be an inhibition to the successful operation of the bank system.

The point is that those who have been opponents of reform for Fannie and Freddie have missed the lessons the bank system has clearly demonstrated, that all of these regulatory constraints have resulted in a better system which performs at a higher level of social mission compliance than Fannie or Freddie. In fact, most commercial banks have more loans in their portfolio to low-and moderate-income individuals than Fannie and Freddie have in their portfolio. And few commercial banks can match up with the bank system's record of performance in that arena.

Now, not to sound like I am in the first row of church at the bank system, I have got one problem and I do not know that there is a good answer to it. One of the distorting effects, I think, in the market from a bank system perspective is the consolidated debt obligation and Banker X's ability to borrow, in essence, on Bank Y's credit. I am not suggesting today, make clear, that we revoke the consolidated debt obligation structure, but I do believe there should be market discipline, in addition to the regulator's function, in evaluation district banks' creditworthiness in some capacity, whether it is some subordinated issue, whether there is a requirement—some vehicle where we require a district to issue debt on its own bottom for the market to respond to the managerial and supervisory issues within that district.

Has there been any discussion or is that even an area which the board has entered into or has concerns about?

Mr. ROSENFELD. We have concerns, Chairman Baker, that all of the banks operate to the very highest credit quality standards that is possible. We have not explored the notion, to my knowledge, of changing the idea of consolidated obligations, but I think that consolidated obligations from everybody's perspective is better served if each one of the components in the consolidation are triple A. So I think we are working—

Chairman BAKER. Well, let me help in a little way. Here is my point, and I appreciate your method of governance, I appreciate your team oversight, but you are not dictating as a finance board what products a bank might engage in, for example the MPP Program. What you do, as I understand it, is once the product is devel-

oped, you assess the risk-taking nature of that product and determine if it is too risky, if it is sufficiently hedged, if the capital is adequate, but you do not tell a bank, "You can do A or you cannot do B."

Mr. ROSENFELD. We do, Congressman. In a sense, a program like that—it happened before I ever was there—but it has to be approved by the Finance Board.

Chairman BAKER. Right, but—

Mr. ROSENFELD. And once it is approved, then we monitor it and make sure that it does not get out of line in terms of what is appropriate for safety and soundness.

Chairman BAKER. Right, but as I am understanding the supervisory role it is to look at the practice and determine if it is sufficiently walled off from a risk-taking perspective, not to represent a clear and present danger to the financial solvency of the institution. But you do not write district banks' business plans; they write their business plans and come to you and say, "Here is what we want to do. Is this okay?" And from a safety and soundness perspective you say, "We like it, but we are going to keep an eye on you." I got that part.

But each bank can get out there on the risk profile in different ways based on their own creativity and innovation of their staff. I am suggesting that strong regulation is not only warranted but necessary, but I would really like just an added dose of market discipline in there somewhere. And the bank system, as you have noted, a little unique in that regard as a member-owned structure, other than the issuance of debt into the market, we do not have the kind of discipline that a Fannie or Freddie would have in the day-to-day trading of a recognized liquid stock, and that is really what I am getting at.

Mr. ROSENFELD. I understand and I agree, and I would point out, Chairman Baker, that we love all of our bank presidents but we also watch them.

Chairman BAKER. I like the old trust but verify myself. I want to thank you.

Mr. Baca, did you—

Mr. BACA. Sure, I would like to ask a question.

Thank you very much, Mr. Chairman.

Recently, the Federal Housing Financial Board approved a rule that would require the Federal Home Loan Banks to register stock with SEC to allow for increase in disclosures. Would you predict that as a result of that that SEC would ever take a rule like that it has taken with Fannie Mae in investigating the financials of the Federal Home Loan Banks?

Mr. ROSENFELD. I could never predict what another organization would do, but my guess is if they thought that there was a need for it, they would do it.

Mr. BACA. The only thing is that I want due process to be done on both as well.

The other question, at least one home loan bank, the Seattle Bank, has decided to exit mortgage purchases business asserting that it is too risky. Do you think that the Federal Home Loan Banks should be in this business?

Mr. ROSENFELD. I think that we all acknowledge that the mortgage programs or managing interest rate risk, which is another way of describing the mortgage programs, is intrinsically a high-risk business. It is just the nature of what it is. I think that having said that, that does not mean that the activity is intrinsically bad. We are looking very carefully at the appropriateness of the activity as well as the extent of the activity. And like so many other things in life, the answer may be in moderation.

I cannot say to you the program is totally good in an unbounded way nor can I tell you that it is totally bad, and we are looking as to what might be the appropriate way to deal with that program. We are very concerned about it. I know the banks are concerned about it. And it is very high on our priority list of coming to some resolution as to just what happens with that program.

Mr. BACA. Bottom line is should they be in this business or not?

Mr. ROSENFELD. Cannot tell you at the moment. The best way I can describe it to you is, at some level the risk does not jeopardize safety and soundness. At the other extreme, I can assure you that if it got big enough, safety and soundness could be jeopardized, and that would be intolerable from our standpoint.

Mr. BACA. Okay. Thank you very much.

Chairman BAKER. The gentleman yields back?

Mr. BACA. I yield back.

Chairman BAKER. Mr. Frank.

Mr. FRANK. Thank you, Mr. Chairman. I have a question, but first I did want to comment, Mr. Chairman, that I think frankly you set out kind of a straw man when you said people who are opposed to reform of Fannie and Freddie, which I think you mean people who do not like your bill, do not understand that affordable housing can be helped. Quite the contrary is the case, and really let's get the record clear here.

This administration, which has been very critical of Fannie and Freddie, let an entire calendar year go by in which they had the authority to increase the affordable housing goals and did not exercise it, because they inherited 2 years of increased goals from the previous administration and in the third year they could have, in the second year of their administration, increased the goals. We asked Mr. Weichert about it and by the time he got around to it it was too late, and when we asked why they had not done it, they said they forgot.

I welcome the new interest in affordable housing in Fannie and Freddie, but I have to say that it does seem to me in some cases to be more a stick that people want to beat them with than something they want to accomplish.

And with regard to an affordable housing program, I am glad to see the enormous support for the Affordable Housing Program. I was here in 1987 when it was a two-vote victory on the floor of the House in a very partisan vote, which created the Affordable Housing Program, and I am glad that people have now accepted the fact on both sides of the aisle that it should be there.

But I also want to point out when we were doing legislation on Fannie Mae and Freddie Mac last year, it was those of us who you have characterized as being opposed to reform who came up with the idea and pushed it legislatively to make the Affordable Housing

Program something they would have to do. Certainly, that is the way it went in the Senate. There was an amendment by Senator Jack Reed, and we were strongly supportive of it.

So quite the contrary is the case, and in fact many of us believe that some of the proposals that are affecting Fannie and Freddie would have too much of an adverse effect on them. We can differ about those, but any suggestion that people who are on the other side of you have not been trying to increase affordable housing I think is exactly the opposite of the case.

And on the affordable housing, and that is the thing that greatly interests me, and we have talked about this before and I mentioned it earlier and I had to go off to another meeting, but I did want to touch on what I think was your willingness to work with us.

We can find a way without getting to the controversial issue of multiple memberships by one institution and several regional banks to try and deal with the problem created by mergers whereby economic activity that is generated by member banks in a particular area could get credited for purposes of the Affordable Housing Program to another region. And to the extent that we can work out some kind of proportionality, I just want to affirm that that is something that we think we can do without interfering with the overall function.

Chairman BAKER. Congressman, immediately after I got back to my office after visiting with you, I said to the gentleman actually behind me that I was visiting with you and you came up with an issue here that I thought was extraordinarily meritorious, and I assure you we are working that issue right now. We share your concerns.

Mr. FRANK. As I said, I want to pay tribute to the banks, the Pittsburgh and Boston Banks and the Sovereign Bank for trying to—essentially, what happened is Sovereign buys up a very active thrift operation in Massachusetts, and I think they worked out a deal where the Boston Bank will be able, in effect, to lend out the money with the agreement of the Pittsburgh Bank. And if we make that available to everybody, I think that would be very helpful.

Chairman BAKER. Incidentally, there is no prohibition against different home loan banks working out such an agreement. What we are trying to do is create some opportunities to facilitate those kinds of—

Mr. FRANK. Okay. Let me just offer this, and I would hope this would be something we could do. If it turns out by the time we get to legislating on this that something we could do could facilitate that, not necessarily in a mandatory way but sometimes there is an unintended consequence of some other provision, I will count on you to let us know so that we can leave you in a legal situation where you can fully take the action. Thank you.

Thank you, Mr. Chairman.

Chairman BAKER. If the gentleman would just further yield, I just want to make sure that there is not an appearance of a split or a chasm here between the gentleman's views and that of my own with regard to affordable housing. I have publicly stated that the gentleman's views on affordable housing goals are desirable and should be included in any legislative approach that this committee should consider.

Just in past years, not speaking directly to the gentleman, I could not get past the safety and soundness issue which I thought were so important to get to affordable housing. I think now in the window in which we are finding ourselves that safety and soundness and affordable housing can be mutually addressed and I think achieve the goals the gentleman—

Mr. FRANK. Well, Mr. Chairman, I am delighted you have made that passage, and I welcome you.

Chairman BAKER. Well, I would point out that I was somewhat involved in the Federal Home Loan Bank System's Design and Modernization Act of 1999 and have always been an advocate, but it is difficult to advocate when the money is not there to meet the goal. And my concern has been that the charter privileges granted to the large enterprises were being utilized to supply significant rate of return to shareholders and not meet their social obligation. And that historically has been there. So I just want to make sure everybody out there knows you and I are together.

Is there any other member wishing to make a statement. If not—

Mr. FRANK. I am sure, Mr. Chairman, that will comfort them as they leave.

Chairman BAKER. Yes. I can see the calm sweeping across the face of the earth.

Mr. Chairman, I want to express my appreciation for your appearance here today, your strong leadership and direction, and we look forward to working with you in the future.

Mr. ROSENFELD. Thank you, sir.

Chairman BAKER. Thank you.

And if I may ask the members of our second panel to come forward as they can.

I want to welcome each of you to our hearing this morning, and just as to the general practice of the committee, your formal statement will be made part of the record. You will be recognized in order to present a summary of your views, and we request that you try to constrain yourselves to within a 5-minute presentation.

And for the purposes of making our initial introduction, I would like to recognize Mr. Davis who has a word to say.

Mr. Davis?

Mr. DAVIS OF KENTUCKY. Thank you, Chairman Baker. This morning I would like to welcome to the subcommittee a constituent of mine residing in Kentucky's fourth district, Dr. David Hehman, who is president and CEO of the Federal Home Loan Bank of Cincinnati, a regional wholesale bank serving 750 member financial institutions in Ohio, Kentucky and Tennessee.

Dr. Hehman oversees the operations of the \$83 billion federal home loan bank, including its multimillion dollar Affordable Housing Program that has created over 31,200 units of affordable housing in the region. He was named president and CEO in 2003 following a 25-year career at the bank in Cincinnati, during which he held positions including chief financial officer and executive vice president.

In addition to these duties at the bank in Cincinnati, Dr. Hehman serves on the Finance Committee and Public Policy and Outreach Committee of the Federal Home Loan Bank President's

Conference and also represents the Federal Home Loan Bank of Cincinnati on the board, the Council of Federal Home Loan Banks and Pentegra's Retirement Fund.

I am also pleased to report that outside his duties with the bank, Dr. Hehman serves on the board of directors of Brighton Properties, Incorporated, a non-profit affordable housing and social services agency in my district in northern Kentucky, and he is a regionally recognized advocate working to increase opportunities for home ownership.

Thank you for being here this morning, Dr. Hehman. We look forward to hearing your testimony, and I yield back to you, Chairman Baker.

Chairman BAKER. I thank the gentleman for his comments, and at this time Mr. Frank also wishes to be recognized to make a brief opening statement.

Mr. FRANK. Thank you for your graciousness, Mr. Chairman.

I am delighted Mr. Jan Miller, who is the president and CEO of Wainwright Bank in Boston is here. The Wainwright Bank has been an extraordinarily creative, socially responsible bank, and I particularly wanted to note that, because among the projects in which they have worked on affordable housing was one in which my mother was very active. It is a very creative program providing aid to homeless women, a group very much neglected. So I am very appreciative of Wainwright for showing how profitability and social responsibility combine, and I thank Mr. Miller for being here.

And I also thank him for his testimony because I often sit and listen or read people's testimony and at the end of that have no idea what they think about the relevant issues, and I have learned a lot about their views on life but none of which help me. On pages four and five, he has a series of bullets, very specifically, talking about what as both from the bank and a member of the board of directors, the Boston Bank, very specific policy recommendations, positively and negatively. I appreciate those. I find myself very persuaded by them.

But I thank him both for the nature of the testimony and for coming, and I appreciate, Mr. Chairman, your letting us do this.

Chairman BAKER. Certainly.

I would now turn to Mr. David Hehman, president and CEO of Federal Home Loan Bank of Cincinnati. Welcome, sir.

Mr. HEHMAN. Thank you, Mr. Chairman, and thank you to Congressman—

Chairman BAKER. You will have to hit the button and then pull it close too.

Mr. HEHMAN. Can you hear me?

Chairman BAKER. There we are.

STATEMENT OF DAVID H. HEHMAN, PRESIDENT AND CHIEF EXECUTIVE OFFICER, FEDERAL HOME LOAN BANK OF CINCINNATI

Mr. HEHMAN. Sorry. Thank you, Mr. Chairman. I would also like to thank Congressman Davis for those kind words.

Mr. Chairman, Ranking Member Kanjorski and members of the committee, I do appreciate the opportunity to speak to you today on behalf of the Council of Federal Home Loan Banks.

Mr. Chairman, I would like to commend you for your commitment and hard work to create a truly world class regulator for the GSEs.

And, Congressman Kanjorski, we commend you on your strong support of the system over the years and your support and your efforts toward strong corporate governance within the system.

As you have heard today, the home loan bank system is quite unique, comprised of 12 regional banks with over 8,000 member institutions. And while the system shares a congressional charter and housing mission with Fannie Mae and Freddie Mac, the banks are fundamentally different.

Our structure is one of 12 regional banks and their members that form a cooperative that is driven by member credit demand without the earnings pressure of a publicly traded stock corporation. And while the 12 banks are independently owned and operated, as you know, they share joint and several liability for the system's debt.

I think the mission perspective in the system is also broader than that of the other housing GSEs. The home loan banks are major providers of advanced funding for housing and community development. The value of these advanced systems goes from their daily availability as well as the actual provision of long-term funding at capital market rates.

Recent research sponsored by the council into the impact of federal home bank advancements on mortgage lending has clearly shown that members of the system hold a significantly higher share of their assets in housing and community development loans compared to non-members. These findings actually confirm those in a July 2002 study sponsored by the Federal Reserve Bank of Cleveland, Ohio.

These studies show a strong correlation between the use of advances and members' willingness and ability to hold mortgage-related assets. Quite simply, the studies confirm the system is doing exactly what the work that Congress had intended.

Two critical pieces of legislation have shaped the home loan banks today. First, of course, is FIRREA of 1989, which expanded membership to include commercial banks and credit unions, established the resolution funding assessment on bank earnings as well as mandated the Affordable Housing Program. As a result of the AHP program, the home loan banks since 1990 have awarded over \$2 billion to create more than 400,000 units of affordable housing throughout the United States.

Title VI of the Gramm-Leach-Bliley Act, sponsored by Congressmen Baker and Kanjorski, provided a permanent capital structure, expanded the types of collateral community institutions can pledge and also increased the independent corporate governance of each bank.

The task of creating permanent capital is nearing completion, as 10 of the 12 banks are now finished with their capital plan. These new structures have left the system with some \$42 billion worth of capital and an aggregate capital asset ration of 4.5 percent.

You have also heard that the Federal Housing Finance Board has recently adopted a final rule regarding each federal home loan bank and the requirement to register a class of equity securities

with the SEC. Under this disclosure, the Federal Home Loan Banks will file their financial statements with the SEC. While the system already has in place a comprehensive reporting system, furnishing SEC reports will further the process of providing transparent statements by which the public can judge the activities of the system.

Last year, recognizing there were serious legislative efforts to reform regulation of the GSEs, the Council of Federal Home Loan Banks adopted guiding principles for such legislation. With respect to the Federal Home Loan Banks, we believe these same principles should apply to regulatory reform under consideration by the current Congress.

First, we believe it is critical that the legislation preserve the Federal Home Loan Banks' mission of providing cost-effective funding to members for use in housing finance and community development. And that legislation should continue to encourage regional affordable housing programs.

Second, it is critical that the legislation provide for a strong independent regulator. In addition, this new regulator must be given all the tools and authority necessary to ensure that Federal Home Loan Banks' advanced mortgage programs operate in a safe and sound manner that is consistent with our mission.

Third, it is critical that the legislation preserve the role and function of the Office of Finance, as they are the office that obviously is involved with the issuance of our debt. Legislation must ensure that neither the U.S. Treasury nor the independent regulatory unit has the ability to impede or limit the Federal Home Loan Banks' access to capital markets without cause.

Fourth, it is critical that the new regulatory structure recognize the unique regional characteristics of the system, including corporate governance at the local level.

Mr. Chairman, the Council of Federal Home Loan Banks supports legislative efforts to achieve a world-class regulatory for the GSEs. From the point of view of the Federal Home Loan Banks, we believe it is important to resolve this matter promptly.

Thank you for the opportunity to address the committee, and I would be happy to answer questions at the appropriate time.

[The prepared statement of David H. Hehman can be found on page 67 in the appendix.]

Chairman BAKER. Thank you very much.

Our next witness is Mr. F. Weller Meyer, president and CEO of Acacia Federal Savings Bank. Welcome.

STATEMENT OF F. WELLER MEYER, PRESIDENT AND CHIEF EXECUTIVE OFFICER, ACACIA FEDERAL SAVINGS BANK

Mr. MEYER. Good morning, Chairman Baker, Ranking Member Kanjorski and members of the subcommittee. My name is Weller Meyer, and I am the president and CEO of Acacia Federal Savings Bank.

Acacia is a \$995 million community bank in Falls Church, Virginia. Acacia's primary business is originating mortgages for families. We are a member of the Federal Home Loan Bank of Atlanta and currently have \$244.1 million of advances outstanding. That is 26.7 percent of our liability. We rely on the Federal Home Loan

Bank System day in and day out to help us do our mortgage lending business.

Community banks have an acknowledged history of superior performance in lending to low-income and minority borrowers and first-time home buyers. The Federal Home Loan Banks support this business with advances and with programs, including the Affordable Housing Program. These activities would not be possible without access to advances.

From a member and user perspective, it is important to retain the highly successful cooperative organization of the system and the ability of the Federal Home Loan Banks to fund the mortgage originations and community development activities of its member institutions.

Like many other banks, Acacia's investment in federal home loan bank stock is the single largest investment we have. The safe and sound operation of the banks and the safety of my investment are critical. Although Acacia is a member of the Federal Home Loan Bank of Atlanta, the organizational structure and the joint and several liability of the banks mean that I am interested in all the activities of all the federal home loan banks.

The Federal Home Loan Bank System needs a strong, independent regulator that has the authority to supervise the individual banks using the current statutory framework of powers. Any new regulator of the Federal Home Loan Banks must have the authority to maintain the banks' access to the capital markets and their current well-defined mission to support the mortgage finance, affordable housing and community development activities of member banks.

In the past 10 years, acquired member asset programs have been developed by several banks to provide the members and the banks that participate an alternative risk management and mortgage funding strategy. The members are able to sell loans to the Federal Home Loan Bank under terms established in the program.

As the programs evolve, some market participants have discussed permitting securitization of the loans as part of the program. I strongly believe that this is a topic that must be studied before any action is taken, and that securitization be considered only in the context of a public review process conducted by the designated federal regulator.

The independence of the future regulator is an important element. A structure that provides autonomy will insulate the regulator from concerns about unintended political influence. Fees that the regulator assesses the Federal Home Loan Banks must be used only to examine and supervise the banks.

The Finance Board has powers and authorities similar to those of the banking regulators in the areas of capital activities and supervision, and they should be preserved.

The Federal Home Loan Banks' stocks and debt instruments should be subject to transparent disclosures that are appropriate for the unique GSE. In June 2004, the Finance Board issued a final rule requiring that each federal home loan bank register a class of securities with the SEC under the Securities Exchange Act of 1934. The disclosure scheme that has been established for public compa-

nies contains a number of requirements that make it difficult for a cooperative system to comply.

I support the inclusion of certain specific securities law exemptions in any legislation. Such exemptions will make it easier for the Federal Home Loan Banks to register and to comply with the disclosure requirements but will also make it easier for interested parties to understand the disclosures and the business of the Federal Home Loan Banks.

In particular, I support a specific provision that would exempt the Federal Home Loan Banks in the system from certain requirements of SEC's Regulation FD. I believe that the composition of the boards of each of the Federal Home Loan Banks is a critical element in ensuring that the governance of the Federal Home Loan Banks is undertaken in an appropriate manner.

Financial business and operating expertise must be demonstrated by the board of each federal home loan bank. I support careful consideration of changes to the statute, regulations and practice that will ensure that each federal home loan bank will have a board that is composed of members with a stake in the system, who understand the commitment and importance of serving on the Federal Home Loan Bank Board.

I wish to again express my appreciation, Chairman Baker, for this opportunity to testify on this important issue. The future of the Federal Home Loan Bank System is important to the day-to-day operations of many community banks, including Acacia, and the communities they serve.

I look forward to working with you and the members of this subcommittee as the legislative process unfolds.

[The prepared statement of F. Weller Meyer can be found on page 76 in the appendix.]

Chairman BAKER. Thank you very much, sir.

Our next witness is Mr. Jan Miller, president and CEO of Wainwright Bank.

Welcome, sir.

**STATEMENT OF JAN MILLER, PRESIDENT AND CHIEF
EXECUTIVE OFFICER, WAINWRIGHT BANK**

Mr. J. MILLER. Thank you, Mr. Chairman. I would also like to thank Congressman Frank for his kind words. The project that he described is one of the most enjoyable that we have done.

As I said, my name is Jan Miller, and I am president and CEO of Wainwright Bank and Trust Company in Boston, and I also serve as an elected director on the Board of the Federal Home Loan Bank of Boston.

Wainwright is a \$750 million socially responsible commercial community bank with 9 branches throughout the Boston metropolitan area. The bank's progressive agenda includes a commitment to affordable housing, community development, social justice, environmental issues, women's rights and the gay and lesbian community.

It is our commitment to affordable housing and community development that is the cornerstone of our organization. We have provided more than \$400 million in financing for these projects over the past decade.

Currently, approximately 40 percent of our commercial loan portfolio is dedicated to community development and non-profit lending, including homeless shelters, special needs housing, food banks, AIDS housing and services, breast cancer research, land preservation, community health centers and other service organizations.

I ran for a seat on the Boston Bank's board, because the Federal Home Loan Banks are a critical partner for community banks like Wainwright. We rely on the Federal Home Loan Bank of Boston as a vital source of liquidity and asset liability management. But equally important, the Boston Bank has been enormously helpful in our efforts to address the needs of affordable housing in the extremely dense, high-cost metropolitan Boston area. Each federal home loan bank commits 10 percent of its net profits to the Affordable Housing Program, which awards grants and subsidized below market rate loans to fund affordable housing developments for the very low, low and moderate income individual and families.

Wainwright has been fortunate enough to win funding for 24 of these such projects. We simply could not have funded these developments, which resulted in 775 units of much needed housing, without the nearly \$6 million in AHP grants and \$12 million in subsidized advances.

Whether it is transforming an empty school into affordable assisted living for the elderly or creating first-time home ownership opportunities for hard-working families or providing quality housing for special needs populations, the homeless and the disabled, the Affordable Housing Program has been an important vehicle to help Wainwright fulfill its mission and strengthen our community.

The Federal Home Loan Banks are as relevant today as they were when Congress created the bank system back in 1932. But if the members of the subcommittee believe it is important for this nation to have diverse, locally based financial institutions serving our communities and not just a handful of very large banks, then it is vital that we keep the Federal Home Loan Bank System strong and vibrant.

Moreover, if you believe, as I do, that private financial institutions have a key role in addressing the need for affordable housing across the nation, the Federal Home Loan Banks are critical.

Congress is wise to establish the bank system as a regional-based cooperative. The Federal Home Loan Banks are well-positioned to meet the unique needs of multifaceted communities across our nation. The housing and community development finance needs could be quite different in New England than those you might find in Chairman Baker's district in Louisiana or in Pennsylvania or in other areas of the country.

The local federal home loan bank knows the laws and local regulations and also the people in the public sector and who to turn to for assistance when the project needs help. They are attune to any changes or any new requirements. The people at the Federal Home Loan Bank of Boston are committed to affordable housing and become our partner in the projects that we finance.

The Affordable Housing Advisory Council brings members of the housing community together frequently to discuss issues, the bank's programs and the needs within the region. It is my belief

that the bank system would not be nearly as effective if it were a one-size-fits all operation.

The directors of the Boston Bank have considered at some length the potential for reforming the regulatory structure for the Federal Home Loan Banks, along with Fannie Mae and Freddie Mac. As a director and a shareholder, I support having a strong and respected regulator for the Federal Home Loan Banks. The Boston Bank, as a member of the Council of Federal Home Loan Banks, supports the guiding principles of legislative reform, as Mr. Hehman has described in his testimony.

More specifically, the Board of Directors of the Boston Bank believe that any GSE reform legislation should have the following elements: The new regulator must be independent outside of the Department of Treasury and dedicate a separate division to oversee the Federal Home Loan Banks; independent directors must continue to be appointed to the boards to maintain representation of the public interest.

Finally, the Boston Bank would strongly oppose the following in any GSE reform legislation: Efforts aimed at minimizing the bank's current GSE status, any efforts to foster consolidation, the imposition of additional financial burdens on the banks. As cooperatives, we already operate on very thin margins.

We believe the Federal Housing Finance Board has sufficient authority to oversee the safety and soundness of the system's Mortgage Purchase Programs and thus would oppose any limits placed on these programs by legislation, limits placed on large members' access to the banks or any restrictions on board governance granted in Gramm-Leach-Bliley.

Mr. Chairman, I appreciate the opportunity to testify this morning. On behalf of Wainwright Bank and the Federal Home Loan Bank of Boston, I look forward to working with you and your colleagues to craft a sound and thoughtful regulatory structure for the Federal Home Loan Banks.

[The prepared statement of Jan Miller can be found on page 83 in the appendix.]

Chairman BAKER. I thank the gentleman.

Our next witness is Mr. Joseph F. Connors, the executive vice president and chief financial officer of Beneficial Savings Bank.

Welcome.

STATEMENT OF JOSEPH F. CONNERS, EXECUTIVE VICE PRESIDENT AND CHIEF FINANCIAL OFFICER, BENEFICIAL SAVINGS BANK

Mr. CONNERS. Thank you, Mr. Chairman, and thanks for the opportunity to come before the subcommittee today to talk about the vital role that the federal home loan bank plays in helping Beneficial and other community banks meet the housing and community credit needs of local communities.

I am Joe Connors. I am at Beneficial Savings Bank. We are a Philadelphia bank with about \$2 billion in assets and 36 branch offices spread throughout the city and its suburbs. Within those suburbs we do have offices located in the districts of two subcommittee members, Representatives Fitzpatrick and Gerlach.

I want to just talk a little bit about the bank itself and history of the bank, because I think there is a reasonable parallel to some of the important issues that are affecting the home loan bank right now.

Beneficial was founded over 150 years ago to serve the underserved. It was founded as a mutual or cooperative company. It remains a mutual cooperative company today, and it was also founded to serve the needs of a local area or a regional market, much like the 12 different Federal Home Loan Banks do in their regions.

Essentially, the history is that in the 1850s waves of immigrants came from Europe due to the potato famine in Ireland as well as unrest and revolution in other parts of central Europe. Philadelphia being the major port city was a recipient of a lot of these immigrants as they came seeking a better life.

They worked hard, they earned money, and they needed a place to save their money. The banks, the commercial banks at that time were not designed for working men and women. They were really there to serve the wealthy business people that were their primary backers. As the earnings of these wealthy people accumulated, they needed a place to stash their savings, and they went to the church.

The local parish priests became their bankers and took their savings, put them in drawers in the basement of the church, and as they savings began to accumulate there were some concerns about security. These concerns were shared by the bishop of Philadelphia at the time, a fellow named John Newman and through his inspiration a group of businessmen got together and formed Beneficial Mutual Savings Bank in 1853.

Bishop Newman, just so you know, subsequently was canonized by the Catholic church as a saint, so we do like to say we are the only bank in the country, maybe in the world, that actually was founded by saint.

[Laughter.]

Now, as I said, the bank was founded as a mutual company, it remains that way today, which basically means that we pay no dividends, we have no shareholders to please, there is no public stock outstanding. That means the bank can really focus its energies on its community and its customers. And we think that is very similar to the mission and to the actual operations of the Federal Home Loan Banks.

Today, the Federal Home Loan Bank of Pittsburgh, of which Beneficial is a member, along with about 341 other member owners, helps us to meet the credit needs of the community. As is the case with a vast majority of federal home loan bank members, Beneficial is not large enough. To access the broadest range of capital markets activities and options to raise money to fund our operations.

The Home Loan Bank of Pittsburgh enables Beneficial to essentially tap global capital markets without having the in-house expertise and resources that a major money center bank would need to have. It allows Beneficial to borrow from the home loan bank at reasonably attractive rates. It is a cooperative, so it adds only a small markup which we can then pass along to our customers in the form of reasonably attractive rates for their housing needs and other credit needs.

The knowledge that we can borrow at any time from the home loan bank, and that our mortgage loans and other eligible collateral will support the bank's funding, allows us to be more active lenders than we otherwise would be. The liquidity that is provided by the federal home loan bank is very important in allowing us to be able to fund our customers' needs on a daily basis.

For example, with the economy expanding, as it has been and continue strong demand for new housing, Beneficial has recently, in the last year or 2, begun using federal home loan bank advances to support construction of new housing in the area, as well as rehabilitation and renovation of existing units in urban neighborhoods and in suburban communities.

Our customers are developers, they are looking for money short term that floats, that they can pay back whenever they want and that they can draw down whenever they want. The way we can structure these borrowings with the Federal Home Loan Banks allows us to meet those needs in almost perfectly correlated transactions, so we take on no additional interest rate risk. We provide resources to the communities that help to build housing units, that help to provide construction jobs and, of course, to make a spread for the bank, which, as I said, as a mutual, simply goes into the reserves of the bank.

We think it is important that the work that the subcommittee is doing as soon as possible can help to restore consumer and investor confidence in the Federal Home Loan Bank System and particularly in Fannie Mae and Freddie Mac. I think that it is very important, because I think that all of these GSEs that support housing are critically important. The homeownership rates in the country have gone up sharply since the founding of the home loan bank back in 1932. I am sure there are a number of reasons for that. However, the federal home loan bank is certainly one of them.

With regard to the legislation that is being considered, we think it is important that this home loan bank is ensured a robust future, that the safety and soundness regulator of the home loan bank is indeed a world-class regulator, that the regulator should have the ability and the flexibility to allow the banks to develop new products over time, that any legislation, and I think this is critical, does not impede the ability of the home loan bank to access capital markets, which they do hundreds of times throughout the day to meet the needs of their community bank customers, that the unique nature of the system, that is 12 independently operated cooperatives, be preserved, and that Congress should ensure that the SEC recognizes that the system does have unique features that really do not apply to other firms, companies and even Fannie Mae and Freddie Mac that the SEC will regulate.

Thanks very much for the opportunity to be here, and I would be glad to answer any questions.

[The prepared statement of Joseph F. Connors can be found on page 54 in the appendix.]

Chairman BAKER. Thank each of you very much. Unless some member objects, I am going to suggest we proceed rather informally. I have got just some principles I would like lay out for you to respond to and then a series of a few questions.

I recognize the unique nature of the bank system's structure and of its function and that community need, to a great extent, drives the product the bank will ultimately deliver. And despite characterizations to the contrary, the housing mission of all GSEs is the reason for their existence. I do not really know of anyone on the committee who would suggest that we should not meet the needs of low-income, first-time homebuyers, minorities. That is how we do it. That is how we achieve those goals. And to assess the enterprises, as in your case, 10 percent of net profit, in order to achieve that goal is a fairly heavy burden. We do not see anything similar on the Fannie-Freddie side of that sort.

And balancing the mission with safety and soundness, that in the effort to provide the revenue you need to accomplish your mission, that untoward risk is not taken on in an ill-advised manner. Therefore, a strong regulator with unilateral authority to act, which I believe the bank system has in the Finance Board structure.

Having said that, those observations do raise a few questions about where we are and where we should go. For example, I did not hear and have not read is there a view of the panel as to whether it is ill-advised or of no consequence to have a single regulator with mission and safety and soundness combined, as does the bank system?

Some will argue on the committee that we must have a separate box somewhere in which mission, product approval activities are reviewed and gauged and kept segregated from the safety and soundness shop. I think, making full disclosure, that it makes a lot of sense to have both in the same facility, as does the current bank model. Do you all have any view on the regulatory structure going forward or no comment? I will take that.

Mr. CONNERS. I will comment. I do not see the need or even the facility of having two separate regulators. I think I would agree with your comments.

Chairman BAKER. Good. Thank you. Anybody else want to get in trouble?

If not, let me jump to sort of the second observation, and Mr. Meyer, you came as close to touching on this with your comments in expressing the view and belief that at each district level there should be sufficient expertise on the board and in the management to appropriately gauge that bank's risk profile and to ensure that nothing goes awry that can be prevented.

That gets right up to that consolidated debt question of mine. If I were in the Dallas Bank and let's assume it was the Washington, D.C. Bank, no reference to Baltimore, Philadelphia, anybody, just making this up, and they got engaged in certain activities that I would never think of in the Dallas Bank was appropriate but yet I am on the hook for that should it go backwards, is that an operational concern of a use of the bank system, and would it be advisable for us to look at some way to on an annual basis have each district issue some sort of security to have a level of market discipline?

Mr. MEYER. Mr. Chairman, I believe that the direction that you are headed with appointment of a strong, independent regulator is the first step in the process. I think that the system, as it has ex-

isted to date, has worked very well. I agree that there is a legitimate concern as to joint and several liability between the banks. I am not sure that I have an answer as to how appropriately that would be handled going forward.

Certainly, from the selling point of having a strong regulator who has safety and soundness oversight and control, I think that is the beginning point. There may be some refinements that would enhance that, but I think it is a legitimate concern.

Chairman BAKER. Good. I just think having someone in the market evaluate a bank's performance is a helpful tool for the regulator, because as we have found out, sometimes the regulator finds it first, sometimes the market finds it first. But when you have got both of them, you have got a chance of finding it.

Anybody else have a comment on that market discipline question?

The other issue that was raised, frankly, by Chairman Greenspan's comments of a couple of weeks ago where he did not find it in itself inappropriate for the banks to engage in securitization, I think it is a good way to move interest rate exposure off your books and into the market as long as you are not subsequently out there buying back your own stuff. That causes me significant concern.

Do any of you have a view as to the appropriateness or desirability for the system to be authorized to enter into the world of securitization?

Mr. HEHMAN. I think as a bank president, I want every tool possible to manage the interest rate risk on my balance sheet. I think Chairman Rosenfeld very clearly pointed out securitization means lots of things to lots of people, and he went from the Ginnie Mae model across the spectrum.

Having said that, I know the Council of Federal Home Loan Banks has not taken a position on this. I can tell you that the board of directors of my bank believes that a legislative fix for securitization is not the answer, but it should be something that the regulator, a strong regulator should be able to evaluate in their safety and soundness role as a proper financial management tool for the Federal Home Loan Banks. So I think it is something they ought to at least consider, give strong consideration to.

Chairman BAKER. Well, from a safety and soundness point, moving interest rate risk exposure off from a housing perspective, if it is to generate revenue for housing mission compliance, that is okay.

Mr. HEHMAN. I understand.

Chairman BAKER. Leveraging your ability to borrow at low rates in the market for other purposes is where I think the concerns would lie.

I also want to explore, Mr. Miller, your comment about the concern about enhanced costs potential with any legislation that might move forward to the bank system.

Mr. Frank and I have had discussions about affordable housing goals. Is it your view the 10 percent now required is the ceiling beyond which we should not go because it may have adverse operational consequences or was that an inappropriate conclusion?

Mr. J. MILLER. The comment more was to additional costs that might be laid on the banks that would reduce their earnings and

reduce the ability to—you know, the 10 percent of the earnings, reduce the amount of money that is available for affordable housing.

Chairman BAKER. Because I do not have any inside knowledge here, but I know that the level of assessment of net operating profit is something that probably will be discussed, and I just wanted to get a clear focus on whether that level of assessment was in today's world an appropriate assessment or was there room to move. And I know if REFCOR went away, that would be an easy thing to answer. But I do not think we are going there.

Unless any of you gentlemen would have further comment, let me just say in my own arena with the Economic Development Program, the EDP program, I have found this to be extraordinarily valuable but extraordinarily misunderstood or not very well known about by member banks, and I am for that purpose convening a little get together in Louisiana soon to have the Dallas Bank come over and talk about it in broad terms.

I do not know how we translate it to the member banks out there in the real world what this program offers and what it means in the way of small business development, but it is a great program and however we can be of help on our side of the fence in making more people aware, I certainly want to offer that.

And then thank each of you for your participation here this morning. It has been most helpful to us. And I can assure you your remarks will be forwarded to every member and will be reviewed in the course of our work going forward.

Our meeting stands adjourned. Thank you.

[Whereupon, at 12:24 p.m., the subcommittee was adjourned.]

A P P E N D I X

March 9, 2005

Opening Statement
Chairman Michael G. Oxley
House Financial Services Committee

**Subcommittee on Capital Markets, Insurance,
and Government Sponsored Enterprises**

**“GSE Reform and the Federal Home Loan Bank System”
March 9, 2005**

The Federal Home Loan Bank System has been critical in helping create a liquid residential mortgage market. The System also plays an important role in small business financing and funding of affordable housing programs. I want to welcome Chairman Rosenfeld to the Committee this morning. He comes to us with an impressive background working in both the private sector and the government. Chairman Rosenfeld assumes the leadership of the Federal Housing Finance Board at a time when Congress is going to be highly active in the oversight and operation of the System.

I want to thank Chairman Baker for holding this important hearing. The views expressed today will be valuable in guiding our decisions as we look to improve the supervision of all of the GSEs.

What a difference 3 years makes. Since 2002 we have learned about accounting irregularities and management reorganizations at Fannie Mae, Freddie Mac, and the Federal Home Loan Bank System. We are now preparing to consider legislation that will improve the oversight of the GSEs by, among other things, consolidating the supervision of these entities into one world-class regulator. Support for legislative action has come from the Administration, Council of Federal Home Loan Banks, the Homebuilders, the Banking trade associations, and the enterprises themselves. It is my hope that we can work together to craft a regulatory structure that ensures the safe and sound operation of these institutions.

The Federal Housing Finance Board recently entered into agreements with the Chicago and Seattle Banks to improve their accounting practices and reform their internal controls. The Seattle Bank has since decided to discontinue holding mortgages in its portfolio and return to the core business of providing advances to its members. I am interested to learn more about the Finance Board's role in this decision and what impact it by will have on the Bank and on the System as a whole.

There has been a lot of discussion recently over the issue of allowing the Banks to securitize mortgages. Some believe that securitization will further increase liquidity in the mortgage market and will help reduce risk to the system. Others contend that securitization is too complex for the Banks to undertake and that it is outside of the core mission of the System. I believe that we need to discuss this issue thoroughly and determine what is the proper course of action to take on this issue.

Sound corporate governance is critical to the functioning of any enterprise. The essence of the Sarbanes-Oxley Act is to ensure that corporate governance is not an afterthought. That being the case, many Members of this Committee, including myself, are concerned that several of the Federal Home Loan Banks are not functioning with complete boards of directors. I would like to further understand why there has been a delay in appointing public interest directors and what reforms to this process Chairman Rosenfeld would support.

Finally, I would like to welcome Dave Hehman, President of the Cincinnati Federal Home Loan Bank to the second panel today. Dave has been a good leader in the System and I look forward to hearing his views on the GSE reform process.

March 9, 2005

Opening Statement by Congressman Paul E. Gillmor
House Financial Services Committee
Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises
Hearing entitled, "GSE Reform and the Federal Home Loan Bank System."

Thank you, Mr. Chairman, for calling this hearing and for your continued leadership on this important issue.

In light of last fall's findings concerning accounting irregularities and failed corporate governance involving a company endowed with our public trust, I hope we can have a full discussion today on the continued need for stronger supervision through a new regulator for Government Sponsored Enterprises (GSEs), created to fulfill a public mission and support our housing market. Again, while I am disappointed that we have not yet been able to pass much-needed reform legislation, I remain optimistic, and look forward to hearing the perspectives of the well-balanced panel of witnesses before us today.

Thank you again, Mr. Chairman, for scheduling this hearing and I look forward to an informative and thorough discussion.

**OPENING REMARKS OF THE HONORABLE RUBEN HINOJOSA
HOUSE FINANCIAL SERVICES COMMITTEE
SUBCOMMITTEE ON CAPITAL MARKETS
“GSE REFORM AND THE FEDERAL HOME LOAN BANKS”
MARCH 9, 2005**

Chairman Baker and Ranking Member Kanjorski,

I want to express my sincere appreciation for you holding this hearing today. It is very important that we continue to review potential reforms to the Government Sponsored Enterprises (GSEs) and the impact they might have on all financial institutions and markets.

Senator Hagel has introduced S. 190, the “Federal Housing Enterprise Regulatory Reform Act of 2005.” I am particularly interested in several of the bill’s provisions. One provision would transfer supervisory authority over Fannie Mae, Freddie Mac, and the regional, cooperative Federal Home Loan Banks to a new, independent agency. Another provision would ensure that the new, independent agency has supervisory powers comparable to federal banking agencies, and the third provision of particular interest to me is the one that would address compensation issues at Fannie Mae and Freddie Mac.

I look forward to addressing those three provisions and others should they come before this Committee for consideration.

Chairman Baker, it is my hope that whatever action we take to reform the Government Sponsored Enterprises, we preserve the Federal Home Loan Bank system and the mission all twelve regional banks share of supporting the nation’s housing finance and community lending system. Communities in my district and countless others across the United States have benefitted from the FHLB Affordable Housing Program. It is especially important that we maintain and protect this program at a time of economic uncertainty.

Having said that, I yield back the remainder of my time.

**OPENING STATEMENT OF
RANKING DEMOCRATIC MEMBER PAUL E. KANJORSKI
SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE,
AND GOVERNMENT SPONSORED ENTERPRISES
HEARING ON REGULATORY REFORM
AND THE FEDERAL HOME LOAN BANK SYSTEM
WEDNESDAY, MARCH 9, 2005**

We meet today to discuss the regulation of the Federal Home Loan Banks. As you know, Mr. Chairman, I share your deep interest in these important financial institutions. After all, we worked closely together for several years to include language to reform the Federal Home Loan Banks during our deliberations over the 1999 law to modernize the financial services industry.

Among other things, these reforms strengthened the corporate governance of the Federal Home Loan Banks, updated their capital structure, and established voluntary membership on equal terms and conditions for all eligible institutions. They also expanded access to the system for small community financial institutions. The changes additionally have helped to pave the way for enhanced targeted economic development lending.

Although some of my colleagues may think the issue is a new one, we have debated how to best regulate the Federal Home Loan Banks for a number of years. Like the regulation of Fannie Mae and Freddie Mac, my goal has been to ensure that we have strong, world-class and independent regulation for the Federal Home Loan Banks.

The current safety and soundness regulation of the Federal Home Loan Banks is actually better than that of the other government-sponsored enterprises. The Federal Housing Finance Board, unlike the Office of Federal Housing Enterprise Oversight, is funded outside of the congressional appropriations process. In addition, a previous survey by the Government Accountability Office determined that the Finance Board has powers that are substantially better than OFHEO's authorities because these authorities more closely align with those of the banking regulators.

Because the Finance Board already has many of the powers that it needs and because the structure of the Federal Home Loan Banks is significantly different from the other housing GSEs, my preference continues to be to consider regulatory changes for these institutions on separate tracks from any regulatory reform bill for Fannie Mae and Freddie Mac. With its increased emphasis on safety and soundness supervision in recent years, the Finance Board has become increasingly more effective in monitoring the Federal Home Loan Banks.

That said, I recognize that there will be a strong push by some to incorporate the Federal Home Loan Banks into any forthcoming GSE reform bill. If we therefore do include the system in the regulatory overhaul, we need to ensure that such legislation will protect the unique nature of the Federal Home Loan Banks and not negatively affect the cost of funds. I also want to ensure that the system can continue to build on its community and economic development initiatives that we authorized six years ago.

Another important concern for me is the need to ensure that an independent voice continues to be heard on the boards of the Federal Home Loan Banks. Public interest directors

have an important role to play in corporate governance. Some of the reforms that we have enacted in recent years have gone too far in limiting the compensation that they can receive for their services. We need to increase the pay of directors, in order to ensure that we can attract quality directors to serve on boards and effectively monitor sophisticated financial products and strategies. We ought to also increase the length of the term of all directors. Finally, we should ensure that directors are appointed in a timely manner.

One final issue that I hope we will address today concerns registration with the Securities and Exchange Commission. Last year, the Finance Board approved a rule to require the banks to register their stock with the Commission, even though such stock is not publicly traded. The banks are now working toward implementing that plan. I do, however, have concerns about how such registration will interplay with the joint-and-several liability of the system. I therefore hope that our witnesses today will address this issue.

In closing, Mr. Chairman, I commend you for your sustained leadership in these matters and look forward to hearing from our witnesses today.

**Opening Statement
Congressman Ed Royce (CA-40)
9 March 2005**

"GSE Reform and the Federal Home Loan Bank System"

Thank you, Mr. Chairman, and thank you for holding this hearing on "GSE Reform and the Federal Home Loan Bank System." I would like to commend the Chairman for his continued leadership on GSE oversight and reform.

For some time I have been a strong advocate of regulatory reform for all three housing GSEs: Fannie Mae, Freddie Mac, and the Federal Home Loan Bank System. In the last Congress, I proposed legislation to create a single regulator for all three entities. In my view, this is the right policy because all three present similar risks to the financial system.

Since unveiling my legislation in June of 2003, there have been numerous headlines about problems at all three housing GSEs. The accounting troubles at Fannie and Freddie seem to have overshadowed the issues in the FHLB System. In the past two years **seven** of the **twelve** FHLBanks have been downgraded or put on negative watch by Standard & Poors (S&P). S&P took such steps because of the increased interest rate risk **and/or** decreased profitability at the seven banks.

The interest rate risk in the FHLB System has increased markedly as the individual banks have stepped-up their purchases of mortgage assets. If managed improperly, this risk could put the entire safety and soundness of the system in jeopardy. I was pleased to read Chairman Rosenfeld's prepared testimony in which he asserts that interest rate risk oversight is the Finance Board's top priority. I encourage the Finance Board to be vigilant in this undertaking.

In addition to our important oversight role in this Committee, I hope that we will move swiftly to create a new regulatory structure for Fannie Mae, Freddie Mac, and the Federal Home Loan Banks. There is a very simple solution -- Congress must create a new regulator with powers at least equal to those of other financial regulators such as the OCC or the Federal Reserve. I hope this Committee will heed the advice of Chairman Greenspan and the entire Board of Governors, the Federal Reserve staff, the U.S. Treasury Department, the OECD, the IMF, and countless other who have urged Congress to act.

Mr. Chairman, thank you for your leadership. I yield back.

Statement for the Record
Congresswoman Nydia M. Velázquez
FSC Hearing on GSE Reform and the Federal Home Loan Banks
March 9, 2005

The housing GSEs, including the Federal Home Loan Banks, play an important role in closing our nation's homeownership gap and increasing the purchasing power of low-income, minority families. Accordingly, we must ensure their ability to serve the vital role of providing liquidity to the mortgage industry and increasing access to affordable homes.

Today we will hear from the regulator of the Federal Home Loan Banks and the member banks who benefit from their services. Knowing the positive impact of the community investment made by the Federal Home Loan Bank of New York, it is crucial that we do not impede the Banks' ability to provide credit to community financial institutions engaged in home mortgage and neighborhood lending.

In the coming weeks and months we, as a Committee, will look at the need to reform the current GSE oversight system to address recent concerns about the safety and soundness of these organizations that play such a critical role in the mortgage industry. In this debate we will be addressing issues such as whether or not to include the FHLBs in GSE reform and, if we do, what aspects of the Banks' activities we choose to alter, if any. I hope that as we move forward we take into consideration the valuable role the FHLBs play in the housing market and ensure that their abilities are only enhanced, not inhibited.

A key factor in the positive impact of the GSEs is their ability to create innovative products for the diverse communities with which they work nationwide. From products to help new immigrant families with non-traditional credit histories to flexible lending programs to allow for multiple generations living under one roof, the GSEs are charged with providing access to homeownership where mainstream financial institutions cannot. We must stay focused on this mission as we move forward, and strengthen the investment in struggling communities where possible.

I look forward to the testimony and discussion we will hear today, especially from the member banks who are in our communities working face to face with the low-moderate income families seeking homes. Your experience will guide us as we draft legislation and look for ways to close the homeownership gap and ensure a safe, stable home for hard-working families across the country.

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Testimony of

Joseph F. Conners
Executive Vice President and Chief Financial Officer
Beneficial Savings Bank

Before the

Capital Markets, Insurance and Government Sponsored Enterprises Subcommittee

Hearing on GSE Reform and the Federal Home Bank System

March 9, 2005

Chairman Baker, Ranking Member Kanjorski and distinguished subcommittee members, thank you for the opportunity to appear before you today to discuss the vital role that the Federal Home Loan Banks play in enabling community banks to meet the housing and economic development credit needs of the communities we serve. My name is Joseph Connors and I am Executive Vice President and Chief Financial Officer of Beneficial Mutual Savings Bank, an independent, community savings bank, with deposits of \$1.6 billion and total assets of \$2.3 billion. While Beneficial is headquartered in Philadelphia, we have branches serving communities in the districts of two members of this subcommittee, Representatives Fitzpatrick and Gerlach.

Beneficial Mutual Savings Bank

So you can fully understand the basis of the remarks that follow, I'd like to give you a little background on Beneficial Savings Bank, which was founded more than 150 years ago as a mutual, or cooperative company.

Philadelphia is truly a melting pot, with a rich tradition of diverse groups of people all contributing to the betterment of the community. Diversity often begins with struggle. The struggle of Irish immigrants in the 1850's was the result of the potato famine that devastated Ireland between 1846 and 1851. During the 1850's, it is estimated that over 100,000 Irish citizens per year escaped their poverty-stricken nation. Unrest and revolution in central Europe added many thousands more to the vast throng who sought

refuge in the United States. As a major port city, Philadelphia was one of the chief points of entry for those seeking a new and better life in America.

The sudden and extraordinary increase in the city's population made labor plentiful and cheap. The immigrants were not only hard working, but thrifty. As their earnings began to accumulate, they needed a secure place to deposit their savings. At the time, most commercial banks were not designed to serve working men and women, but instead catered to the wealthy businessmen who were their primary backers. In order to qualify for a bank account, applicants were required to provide formal identification records, along with personal referrals from established bank members.

Without a bank at their disposal, many of these new citizens turned to another established organization that was more than happy to welcome them, the Catholic Church. It was not uncommon at this time to find parish priests filling the role of banker, safekeeping the meager savings of the new members of their congregations. As balances began to build, priests became concerned about security, and so did John Neumann, the Bishop of Philadelphia. A truly visionary man, Bishop Neumann, a pioneer of the Parochial School System in America, who was canonized as a Saint by the Church in 1977, saw the risks in the patchwork financial system his parishes were operating, and began investigating ways to address the issue.

Bishop Neumann's inspiration was the catalyst behind the founding of what would become Beneficial Mutual Savings Bank. In February 1853, a group of dedicated

businessmen, members of the Board of Managers of St. Joseph's Hospital in Philadelphia, began meeting to address the issue. On April 20, 1853, The Beneficial Saving Fund Society of Philadelphia was incorporated.

The founding board structured Beneficial as a mutual company, and it remains mutual today. Much like the Federal Home Loan Banks, Beneficial is "owned" by its customers. Unlike public companies, whose main focus is to maximize the wealth of their shareholder-owners, Beneficial's management is primarily accountable to its customers and the neighborhoods and communities it serves.

From these humble beginnings, Beneficial has grown and flourished, through its network of 36 neighborhood offices, into a quintessential community bank, offering a full range of financial products and services to all of the residents of Philadelphia, Bucks, Chester, Delaware and Montgomery counties in Pennsylvania, and Burlington County in New Jersey. In so doing, Beneficial Savings Bank has remained a vital part of these neighborhoods, and in the lives of the people who live, work and raise their families in the Philadelphia region. The 550 people who work at Beneficial Savings Bank have a vested interest in this community, because we live, work and raise our families here as well. We demonstrate this interest by being available and responsive to help meet the needs of our customers and our community with both human and financial capital.

The Federal Home Loan Bank of Pittsburgh (the Bank) helps enable Beneficial and the other 341 member/owner financial institutions of this cooperative government

sponsored enterprise (GSE) to meet the housing credit needs of communities throughout Pennsylvania, Delaware, West Virginia and everywhere else member institutions have business operations, just as the other 11 Federal Home Loan Banks provide similar service to over 8000 financial institutions across the country.

Capital Market Access

As is the case with the vast majority of FHLBank members, Beneficial is not large enough to access the broadest range of capital market options on our own. The Bank enables Beneficial to tap global capital markets, as do the largest money center banks.

The Bank accesses capital markets jointly with all the other FHLBanks. The FHLBank System often goes to market over a hundred times a day to ensure that the funding needs of community banks like Beneficial will be met on a timely and affordable basis. Because it is a GSE, the FHLBank System can borrow at very attractive rates. Because it is a cooperative, it adds a very small markup to these funds that it subsequently lends to member institutions. Member banks then pass these savings on to consumers.

FHLBank loans to members, known as advances, are the only capital market access for many FHLBank members and serve as an important resource to deal with any possible future credit crunches. Advances are a reliable, accessible funding source available during all phases of the business cycle. Should consumer demand for deposits weaken or become more expensive, we have this valuable alternative source of funds. This means that the credit needs

of our communities will be met in any number of economic scenarios. It also means that we are safer, from a regulatory perspective, as a financial institution than we would be without this crucial liquidity facility.

The knowledge that we can borrow at any time from the Home Loan Bank, and that our mortgage loans and other eligible collateral will support Home Loan Bank funding, allows us to be more active lenders in our communities than we otherwise would be. We can also tailor FHLBank funding to meet our needs. We can structure the debt in terms of maturity and conditions to meet strategic asset-liability management goals or to fund specific lending products. We can then use this money to support our community lending initiatives.

Recently, with the economy expanding, and the continued strong demand for new housing, Beneficial has begun to use Federal Home Loan Bank advances to support construction of new housing, as well as the rehabilitation and renovation of existing units both in the urban neighborhoods of Philadelphia and in the suburban communities in the surrounding counties. Developers generally look to finance these projects with short-term, variable rate construction loans, often indexed to the prime rate. They draw down funds when needed, and have the ability to pay these loans off at any time. In order to meet this demand, Beneficial has established an Open RepoPlus line with the Federal Home Loan Bank of Pittsburgh. With this line, we can borrow funds at a favorable rate and closely match the cash flow characteristics of our construction loans. We can increase or draw down the line in concert with the needs of our developer customers. In

this way, we can effectively manage interest rate risk, while confidently supporting the creation of new housing, and construction jobs in our region.

A Regionally Operated Cooperative

An essential element of the FHLBank System that has been instrumental in making it the unique GSE that it is today is the fact that there are 12 independently operated cooperatives throughout the country. As one of 341 member/owners of one of these cooperatives, we know that we will get the attention of the Bank's senior management or board members that we would not get if only one large FHLBank served the entire country. In addition, the regional control of the Home Loan Banks helps ensure that local credit needs are met in a manner that might not occur with a monolithic approach. Within this framework of independently operated cooperatives, we believe it is important for the Banks in the System to work together to seek efficiencies in order to make the System stronger and to further support affordable housing throughout every region of the United States.

The fact that, like Beneficial, the Federal Home Loan Banks are cooperatives also means that our GSE is not striving to meet analysts' quarterly earnings expectations and those of investors of a publicly traded stock. The fact that Federal Home Loan Banks are not built on the typical corporate model means that they can provide a level of service to community banks that would otherwise not be available. It means that Beneficial gets the

attention and advice from the Pittsburgh Bank that it would not get from a money center bank or an investment bank.

Finally, as a cooperative, the Home Loan Bank focuses on serving its members because we are the owners. As owner institutions focusing on serving the housing and community credit needs of our communities, we will continue to partner with our Home Loan Bank to see that we evolve together to meet these essential needs.

Funds for Affordable Housing Grants

One of the best aspects of FHLBank membership for Beneficial has been our ability to partner with affordable housing groups and the Bank to make affordable housing possible for low-income families in the Philadelphia region. As you know, FHLBanks contribute 10 percent of their net income to the Affordable Housing Program (AHP) which is the source of grants and subsidies that are used by member institutions who partner with affordable housing providers to finance affordable rental and owner-occupied housing.

An important component of the AHP is the Home Buyer Equity Fund (HBEF), in which qualified low-to-moderate income first-time homebuyers can use HBEF funds toward down payment and closing costs to purchase a home of their own. To participate, qualified homebuyers must secure sponsorship from an approved Federal Home Loan Bank of Pittsburgh member financial institution through which the HBEF funds are disbursed. Through the HBEF, the Federal Home Loan Bank of Pittsburgh matches the participant's contribution 3-

to-1, based on the qualified participant's need. For every \$1 of contribution, the FHLBank will provide up to \$3 in grant assistance, with a maximum contribution of \$3,000.

Since 1990, the Bank has awarded more than \$104 million in AHP subsidies — leveraging \$1.7 billion in total development costs — that has resulted in more than 18,000 affordable housing units throughout the region. Under the HBEF, the Bank has distributed \$14.5 million to more than 3,800 qualified buyers from 1997 through 2004.

Beneficial has been an active AHP participant. We have secured \$740,000 in funding that has made two wonderful projects possible. St. Ignatius Senior Housing, which is located in West Philadelphia, provides 67 units of elderly housing targeted to those individuals whose income is at 50% or less of the area's HUD median income. The other project, Dreuding Center, is located in North Philadelphia and is a 30-unit rental project providing transitional housing for homeless single women with children.

In the past four years, Beneficial's mortgage department also has distributed \$1,115,330 in Home Buyer Equity Fund grants, enabling 264 low-income families to realize their dream of homeownership.

I am quite proud to note that Beneficial was recognized for its excellence in this area by the Bank and received the Pillar of the Community Award in 2003. In addition to working with the Bank, Beneficial also provides additional financial support, approaching \$800,000 in 2004, to community and non-profit initiatives, as well as invests

in low-income housing bonds and tax credits. Beneficial also funds investments in several Community Development Financial Institutions, and has long been active in providing home loans to low-to-moderate income borrowers through programs such as the Delaware Valley Housing Partnership.

The most visible element of Beneficial's commitment to the community is our people. We encourage our employees to channel their good intentions, skills and energies to help their neighbors through a Volunteer Support Group, which is established to coordinate the varied volunteer and charitable endeavors of our employees to maximize the impact of our efforts. The efforts include fundraisers for charitable groups, reading programs for children, book drives for local schools and construction of a Habitat for Humanity home. Beneficial and our employees are becoming increasingly involved in the financial literacy movement, helping to teach people, from students to senior citizens, the basics of banking and credit, and how to better manage their finances.

While we have taken actions to support affordable housing through our own initiatives, our partnership with the Bank enables Beneficial to do so much more to facilitate meeting the housing needs of low-to-moderate income families.

GSE Reform legislation

As a community bank that views the Home Loan Banks as a key partner in our future ability to meet the credit needs of our market, there are a few points I would

respectfully submit for the Subcommittee's attention as you proceed with the important work of reforming the regulatory structure overseeing the housing GSEs.

- Our investment in the capital stock of the Pittsburgh Bank is an important asset of Beneficial Savings bank. The products of the FHLBanks are important for the housing and community development needs of the communities we serve. To ensure that the Home Loan Bank System has a robust future, we urge that you ensure that the safety and soundness regulator of the FHLBanks is indeed a world-class regulator with all the tools that one would expect for such a regulator. We also would hope that the regulator has the flexibility to allow the Home Loan Banks to develop new products over time to respond to future member needs.

- The ability of Beneficial Savings Bank to borrow money as needed on favorable terms is essential and lies at the very heart of the Federal Home Loan Bank System. Any legislation that impedes the ability of FHLBanks to access capital markets, or causes the costs of FHLBank borrowing to increase, would impede Beneficial Savings Bank's ability to safely and efficiently meet the housing and community credit needs of the communities we serve.

- The unique nature of the System, with 12 independently operated cooperatives must be preserved in any new regulatory structure. It is also important that the Congress ensure that the SEC recognizes these unique features as the FHLBanks register with the SEC.

- Governance of any corporate entity is of the utmost importance, and Congress must ensure that the legislation provides the FHLBanks with the unique and comprehensive governance structure it will need. SEC registration, with its resulting Sarbanes/Oxley requirements, makes governance an even more critical component of this legislation.

Despite the recent difficulties encountered by Fannie Mae and Freddie Mac, I believe their viability, along with that of the Federal Home Loan Banks, is crucial to the well being of the financial system of the United States, and to the hopes and dreams of millions of American families. Since the Great Depression, federal support for housing has been an enduring national public policy objective. It is one that has worked. In 1932, when the Federal Home Loan Bank System was created by Congress to promote housing finance, the U.S. aggregate homeownership rate, that is, the percentage of U.S. households living in owner-occupied units, was about 45%, and declining. Today, homeownership in America has reached 68%. It is undeniable that, for more than 70 years, the Federal Home Loan Banks have contributed to bringing the dream of homeownership closer to reality for millions of Americans.

In the years since their founding, Fannie Mae and Freddie Mac have also made a difference, helping to make mortgage credit more readily available and more affordable, and helping to expand the types of mortgage products available, thereby attracting

investors both here and abroad to support consumers in their quest for the independence, stability and equity-building opportunity associated with home ownership.

Ongoing federal support for housing is a critical element in the economic future of American consumers, and in our ability as the pre-eminent economy in the world, to continue to expand. I believe it is in the best interest of our nation's economy that Congress works to reform the regulatory structure of GSEs in a way that will, as soon as possible, restore the utmost consumer and investor confidence in Fannie Mae, Freddie Mac and the Federal Home Loan Banks.

In closing, I would like to offer Beneficial Savings Bank as an example of a community Bank that is vital and is expanding its products and services to help our customers achieve their financial goals. Beneficial is strengthening its commitment to the community, and is confident of a very bright, prosperous future. We look forward to doing so in partnership with the Federal Home Loan Bank of Pittsburgh.

Thank you for the opportunity to appear before you today and I would be happy to answer any questions you might have.

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Statement of

**David Hehman
President and CEO
Federal Home Loan Bank of Cincinnati**

Before the

**House Financial Services Committee
Subcommittee on Capital Markets, Insurance, and Government-Sponsored Enterprises**

March 9, 2005

Mr. Chairman, Ranking Member Kanjorski, and Members of the Committee, I appreciate the opportunity to speak to you today on behalf of the Council of Federal Home Loan Banks (Council) about the Federal Home Loan Banks (FHLBanks) and legislative proposals to reform regulation of the housing government-sponsored enterprises (GSEs). My name is David Hehman and I am President and CEO of the Federal Home Loan Bank of Cincinnati (Cincinnati FHLBank).

At the outset I would like to commend you, Chairman Baker, for your commitment and hard work to ensure the GSEs have a truly world class regulator with the necessary regulatory tools to ensure that the GSEs fulfill their missions in a safe and sound fashion. Likewise, Ranking Member Kanjorski, I commend you for your strong support of the Federal Home Loan Bank System (System) over the years, and your commitment to ensuring that the System operates in a safe and sound manner with the best corporate governance practices. The Council, which represents all twelve Federal Home Loan Banks, believes that it is important to resolve the legislative uncertainty and proceed to the enactment of meaningful regulatory reform legislation as soon as practicable.

FHLBank Overview

The FHLBanks were created in 1932 to support America's housing finance system through its member thrift institutions. With the expansion of members to include commercial banks and credit unions, the FHLBanks now play an even greater role in the nation's housing finance and community lending system. Member institutions use the FHLBanks' advance programs to meet the mortgage and community lending needs of their local markets, and utilize our Affordable Housing Programs to help thousands of low-income families obtain decent housing. In addition, the FHLBanks' mortgage purchase programs provide our members, particularly smaller-sized institutions, a desirable secondary market alternative.

The System is unique, comprised of twelve regional FHLBanks, their 8,100 member financial institutions and the Office of Finance that issues debt on behalf of the twelve regional FHLBanks. The regional FHLBanks are overseen by an independent regulator, the Federal

Housing Finance Board (Finance Board). While the System shares a congressional charter and housing mission with Fannie Mae and Freddie Mac, the FHLBanks are fundamentally different in both structure and perspective from these institutions. The structure is one of twelve regional FHLBanks and their members that form a cooperative driven by customer credit demand. And while the twelve FHLBanks are independently owned and operated, they share joint and several liability for the System's debt.

The mission perspective of the System is also different and broader than that of the other housing GSEs. The FHLBanks are major providers of advances funding for housing and community development. The value of FHLBank advances stems from both the daily available liquidity and the actual provision of short- and long-term funding at capital market rates. Recent research sponsored by the Council into the impact of FHLBank advances on mortgage lending has shown that members of the System hold a significantly higher share of their assets in housing and community development loans compared to non-members. These findings confirmed those in an earlier study (July, 2002) sponsored by the Federal Reserve Bank of Cleveland. These studies show a strong correlation between the use of advances and the members' willingness and ability to hold mortgage-related assets. Quite simply, the studies confirmed the System is doing exactly the work the Congress had intended.

Legislative Overview

Congress has historically taken an active role in defining the mission and structure of the System. Two critical pieces of legislation shaped today's FHLBanks. The Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA) expanded membership to include commercial banks and credit unions with a demonstrated commitment to housing finance. FIRREA also created the System's Resolution Funding Corporation assessment on FHLBank earnings and mandated the Affordable Housing Program through which each FHLBank sets aside 10 percent of net earnings annually for the creation of affordable housing throughout the nation. As a direct result of this program the FHLBanks have awarded over \$2.0 billion to create more than 400,000 affordable housing units since 1990.

Title VI of the Gramm-Leach-Bliley Act of 1999, sponsored by Congressmen Baker and Kanjorski, established universal voluntary membership; provided for a permanent capital structure; expanded the types of collateral that community institutions can pledge to secure advances, and increased the independent corporate governance of each FHLBank.

Ten (10) FHLBanks, including Cincinnati, have implemented newly required capital stock plans. This monumental task occurred well within the legislative time frame, and is due in no small part to the strength of the System's independent regulator and the commitment of the boards of directors at each FHLBank. The new capital structures have left the System with approximately \$42 billion of capital with an aggregate capital-to-assets ratio of approximately 4.5 percent as of year-end.

These two pieces of legislation, combined with the performance of the FHLBanks in the marketplace and customer demand for FHLBank products, resulted in considerable growth over the last decade. At year-end 2004, the FHLBanks had combined total assets of approximately \$930 billion compared to \$241 billion a decade ago. This growth is a direct result of an increase of more than 2,800 members in the past 10 years to just over 8,100.

Independent Regulator

The FHLBanks can best support and build upon our successful record with a strong, independent regulator, engaged corporate governance, and effective risk management. Under our current regulatory regime, the Finance Board's primary duty is "to ensure that the FHLBanks operate in a financially safe and sound manner." The Finance Board is not limited by funding constraints in carrying out its declared focus of ensuring the FHLBanks' safety and soundness. Its funding is provided by assessments on the FHLBanks that are not subject to review or challenge by the FHLBanks. Finance Board regulations govern a broad range of FHLBanks' operations including advances pricing, risk management, capital plan approval, directors' responsibilities and new business activities. The Finance Board also collects and monitors financial and risk management data from the FHLBanks each month, performs ongoing reviews of all aspects of the FHLBanks' operations and conducts annual on-site examinations of all 12

FHLBanks. The FHLBanks all believe that it is essential to maintain a strong, independent regulator with the resources to ensure the FHLBanks' continued safety and soundness as well as to oversee the housing mission. This independence has been a key element in the long-term safe and sound track record of the FHLBanks.

Corporate Governance

Finance Board regulations require the FHLBanks' boards of directors to fulfill the typical corporate director duties. These include the responsibility to select and oversee management, ensure the establishment and maintenance of an adequate internal control system, the responsibility to adopt a risk management policy, a strategic business plan, a member products policy that details the FHLBank's credit and pricing policies, and the responsibility to approve the FHLBanks' annual operating and capital budgets and quarterly dividends.

In carrying out their responsibilities, the boards of directors typically establish and act through committees. Finance Board regulations require each FHLBank's board of directors to have an audit committee with very specific regulatory responsibilities, including direct oversight of the FHLBank's internal and external audit functions. The boards of directors also typically establish other committees to facilitate their oversight of management. Committees vary from FHLBank to FHLBank, but typically include risk management, credit policy, human resources, and housing oversight functions. The various elements of the FHLBanks' corporate governance structure result in boards of directors that are active, knowledgeable, engaged, and fully aware of their responsibilities.

Risk Management

As one of 12 independent institutions, the Cincinnati FHLBank is responsible for its own risk management activities. Our risk profile is guided by a number of regulatory factors common across the System. The FHLBanks are required by regulation to adopt a Financial Management Policy which governs investment, funding, and hedging activities and overall risk limitations. FHLBanks are subject to a minimum 4.0 capital-to-asset ratio as well as a risk-based capital requirement. The FHLBank minimizes credit risk by over-collateralizing advances, limiting

investments to highly rated securities, and establishing appropriate risk sharing features for mortgage purchase programs. No FHLBank has ever suffered a credit loss on an advance to its members in its 72-year history.

The one potential source of risk to the FHLBanks is interest rate risk. Each FHLBank uses sophisticated, high quality financial models to continually assess the magnitude of the risk to earnings and the estimated market value of equity and earnings from changes in interest rates, mortgage prepayment speeds, and other market variables. A part of this process does involve the use of various derivatives such as interest rate swaps. Derivative positions are marked to market on a regular basis and appropriate collateral is in place at all times. Financial management policies limit the use of derivatives to hedging only. Like all users of derivatives, the FHLBanks have also learned to deal with the complex accounting rules required for these transactions.

Beyond the board-established policies which conservatively limit a FHLBank's risk profile, the cooperative structure of the FHLBanks eliminates many of the incentives a publicly traded company might have to raise its risk exposure in search of higher returns. The primary mission of the cooperative is to provide member institutions the funding and financial services they need to meet the credit needs of their communities. At the same time, the FHLBank must generate an adequate dividend return to member shareholders that meets their opportunity cost of investing capital in a low risk enterprise. Rates of return on FHLBank stock have averaged in the neighborhood of three to five percent in recent years, far below the return expected from publicly traded corporations.

SEC Registration Status

At its June 23, 2004 meeting, the Federal Housing Finance Board voted 4-0 to approve a final rule to require each FHLBank to register a class of its equity securities under Section 12(g) of the Securities Exchange Act of 1934. This registration would subject the FHLBanks to the SEC's disclosure regime – requiring the FHLBanks to file quarterly, annual, and supplemental financial disclosures with the SEC.

The final rule requires each FHLBank to publicly file their first 1934 Act documents – Form 10s – no later than June 30, 2005, and to have their registrations effective no later than August 29, 2005. The FHLBanks are currently engaged in ongoing negotiations with the SEC staff to address issues associated with FHLBank SEC registration – many of which stem from the unique cooperative nature of the FHLBank System. To underscore the FHLBanks’ cooperative structure, the Council has supported some technical language in the Senate version of the GSE bill which we would request you to consider as well. While the System already has in place a comprehensive SEC-like financial reporting system, providing SEC reports will further the process of providing transparent statements by which the public can judge the activities of the System.

Guiding Principles for Legislative Reform

The combination of congressionally determined financial requirements, an independent regulator, engaged boards of directors and extensive risk management tools has proven to be a successful model. The 12 FHLBanks currently provide over \$580 billion of advances funding to their member institutions, serving virtually every neighborhood in America. The flexibility of the FHLBank model has allowed for adaptation over time in response to changing financial industry conditions and market environments.

Recognizing that there were very serious legislative efforts to reform regulation of the GSEs in the last Congress and that there was a great likelihood that the Federal Home Loan Banks would be included in this legislation, the Council adopted “Guiding Principles” for legislative reform. With respect to the Federal Home Loan Banks, we believe that these same principles should apply to regulatory reform legislation under consideration in the 109th Congress:

First, it is critical that the legislation preserve the FHLBanks’ mission of providing cost-effective funding to members for use in housing finance and community development; encouraging regional affordable housing programs, which creates housing opportunities for low- and moderate-income families; and supporting housing finance through advances and

mortgage programs.

Second, it is critical that the legislation provide for a strong, independent regulator. This regulator should be protected by Congress, as other bank regulatory agencies have been – such as OTS and OCC –from intervention by any other agency on policy, rulemaking, application, adjudicative and budget matters. The new regulator must be given all of the authority and regulatory tools necessary to ensure that FHLBank advance and mortgage programs can operate going forward in a safe and sound manner that is consistent with their mission.

Third, it is critical that the legislation preserve the role and function of the Office of Finance. The legislation must ensure that neither the U.S. Treasury, nor the independent GSE regulatory unit, has the ability to impede or limit the FHLBanks' access to the capital markets without cause.

Fourth, it is critical that the legislation maintain the unique characteristics of the regional structure of the 12 FHLBanks and provide a regulatory structure designed to recognize these unique characteristics. The legislation should maintain the devolution of governance powers to the individual FHLBanks' boards of directors. In the event that the legislation does not provide for the appointment of non-member directors, we believe that it is important from the perspective of good corporate governance to provide for a category of non-member directors, including community interest directors, and a process for their selection. The Council also unanimously supports the elimination of director compensation caps, as well as the extension of terms for all directors from three years to four, as was included in regulatory relief legislation (H.R. 1375) passed by the House in the last Congress.

Conclusion

The Council of Federal Home Loan Banks supports legislative efforts to achieve a world class regulator for the GSEs. From the point of view of the FHLBanks, we believe it is critical that such legislation preserve the mission of the FHLBanks, provide for a strong, independent

regulator, preserve the funding for the FHLBank System and preserve the unique regional cooperative nature of the FHLBank System.

Mr. Chairman, thank you for the opportunity to address the Committee on this important matter. I will be happy to answer questions at the appropriate time.

Testimony of

**F. Weller Meyer
President and CEO
Acacia Federal Savings Bank
Falls Church, Virginia**

on

“GSE Reform and the Federal Home Loan Bank System”

before the

**Capital Markets, Insurance and
Government Sponsored Enterprises Subcommittee**

of the

Committee on Financial Services

of the

U.S. House of Representatives

on

March 9, 2005

Good Morning Chairman Baker, Ranking Member Kanjorski, and members of the Subcommittee. My name is Weller Meyer and I am the President and CEO of Acacia Federal Savings Bank. I welcome the opportunity to testify before the Subcommittee on the Federal Home Loan Bank System.

Acacia is a \$995 million community bank in Falls Church, Virginia. Acacia's primary business is originating mortgages for families. We originated 1,187 in mortgages in 2004, for a total of \$327.7 million. We are a member of the Federal Home Loan Bank of Atlanta and we have \$244.1 million of advances outstanding, which comprises 26.7 percent of our liabilities. We could not offer the mortgage products we did if we did not have access to FHLBank advances. We rely on the FHLBank System day in and day out and we have as long as we have been a member.

As an indication of the importance of the FHLBank System to the liquidity and funding of community banks, a recent study by America's Community Bankers indicated that advances comprised 21 percent of the liabilities for member banks active in the System.¹ Further, in the recent Survey of Community Bank Executives conducted by Grant Thornton, 56 percent of the respondents reported that they used FHLBank advances as a source of funding in 2004 and 63 percent expect to use them in 2005.² These numbers confirm the importance of the FHLBank System to a broad base of community banks and are an indication of the evolution of the System in the past 15 years.

Community banks have an acknowledged history of superior performance in lending to low income and minority borrowers. For instance, studies reported by the Federal Reserve have shown that "depository institutions have higher portfolio and market shares than the two for-profit government-sponsored enterprises that are active in the secondary market, the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac")."³ The FHLBanks support this business with advances and with programs, including the Affordable Housing Program, which provide any number of examples of successful public/private partnerships. Community banks also have a strong record of lending to first time homebuyers. In 2004, according to a survey conducted by America's Community Bankers, respondents reported that 12 percent of first mortgage loans were made to first time home buyers.⁴ These activities would not have been possible without the access to advances and the local programs that are made possible because of the FHLBanks.

Further, like many other banks, Acacia's investment in FHLBank stock is the single largest investment that we have. As a member of the FHLBank of Atlanta, the safe and sound operation of the Bank and the safety of my investment are critical. As a banker, I understand the importance of good supervision and oversight for both safety and soundness and mission. I support an operating model for the FHLBanks that is founded on the current statutory authorities and a strong regulator that provides oversight. As I mentioned, Acacia is a member of the FHLBank of Atlanta, but because of the cooperative organizational structure and the joint and several liability

¹ *Washington e-Perspective*, America's Community Bankers, March 9, 2005

² *Twelfth Annual Survey of Community Bank Executives*, Grant Thornton, March 2005

³ Volume 82, *Federal Reserve Bulletin* Number 12: page 1077

⁴ *2005 Real Estate Lending Survey*, America's Community Bankers, February 2005

of certain activities of the Banks, I am interested in the activities of all of the FHLBanks and how those activities could affect my investment and my ability to obtain funding.

The System is a member-owned cooperative that has evolved over time but that continues to provide a much needed source of funds for the majority of its member institutions. Advances make it possible for community banks to make sound home loans that may not conform to the strict criteria of the secondary market. FHLBank advances also provide an important alternative funding source for community banks that choose to keep loans they originate – whether conforming or not – in their own portfolios. Community banks rely on the advance window for borrowing where other funding alternatives are not readily available. In considering the future of the System, from a member and user perspective it is important to retain the highly successful cooperative organization of the System and the ability of the FHLBanks to fund the mortgage originations and community development activities of its member institutions.

As the debate progresses, and Congress considers the concerns common to the FHLBank System and the secondary market Government Sponsored Enterprises (“GSEs”), Fannie Mae and Freddie Mac, I urge you to ensure that the legislation provides a new regulatory structure that recognizes the unique and successful business model of the FHLBank System. Unlike Freddie Mac and Fannie Mae, the System is a cooperative owned by its member institutions. The FHLBanks’ stock is not publicly traded and does not fluctuate in value. In addition, each of the FHLBanks is jointly and severally liable to all the others. Fannie Mae and Freddie Mac are publicly held companies. Each of these GSE business models has their strengths. Any revised regulatory system should continue to respect those differences, while advancing the common goal – to maintain their financial safety and soundness.

The core function of the FHLBank System is to provide vital liquidity to its member financial institutions in support of residential and community-based lending. The FHLBanks should continue to focus on the funding of housing lending, while accommodating the new, expanded range of collateral permitted to community financial institutions (as defined in the Gramm-Leach-Bliley Act to be FDIC-insured depositories under \$500 million in total assets).

Background

The FHLBank System was established in 1932 as a source of liquidity for savings and loan associations which were the primary home mortgage lenders in America. These institutions were required to be members of the individual FHLBank in their regions and were required to collateralize the advances with home mortgage loans. At the time, these institutions were generally unable to obtain funding by any other means than deposit gathering. Without the System providing advances at reasonable cost to these institutions, millions of Americans would not have been able to become homeowners.

Even with the creation and expansion of the secondary market for mortgage loans, many lenders would not be able to serve their customers without funding from the FHLBanks. This is evident in the continual reliance on advances funding by member institutions. The loans these lenders make are frequently non-conforming or may be part of a targeted program. Community banks also often do not want to sell all of their loans to the secondary market because they prefer to

maintain customer contact and service. The System provides a source of funding for those institutions wishing to retain those loans in portfolio. This is still true today despite the growth of the secondary market and the changing business of community banks.

In 1989, as part of the Financial Institutions Reform, Recovery and Enforcement Act, the System membership was opened up to commercial banks and credit unions, and the operations of the individual FHLBanks were separated from the supervisory functions that they had provided since 1932. The current regulator, the Federal Housing Finance Board ("FHFB"), was created. In 1999, the System changed again with the imposition of new capital requirements and expanded collateral options.

The FHLBank System has grown with the addition of commercial banks and credit unions. The organization and structure of each of the Banks has evolved from an entity that was a regional supervisor as well as a provider of back office services and advances to a System of 12 Banks. What has not changed is the cooperative structure of the System and the requirement that only members can access advances.

In the mid 1990's the FHFB, working with several of the FHLBanks, developed mortgage programs that are generally referred to as acquired member asset ("AMA") programs. Currently there are two programs, the Mortgage Partnership Finance and the Mortgage Purchase Program. These programs were developed to provide the members and the Banks that participate an alternative risk management and mortgage funding strategy. The members are able to sell loans to the FHLBank under terms established in the programs.

As the programs evolve to meet needs of the Banks that developed them and the members who use them, some market participants have discussed permitting securitization of the loans as part of the programs. Presently, there are no proposals from the Banks before the FHFB to permit such securitization. I strongly believe that this is a topic that must be studied before any action is taken, and that securitization be considered only in the context of a public review process conducted by the designated federal regulator.

The FHFB has evolved as a regulator. In the past few years, a greater emphasis has been placed on the safe and sound operation of the Banks and on the supervision of the System. The examination staff has grown in number as well as in expertise as a reflection of the greater understanding of the importance of having a strong regulator. Any legislation must continue this trend.

The Future of the System

Any legislative debate should reflect the differences between the Federal Home Loan Bank System and Fannie Mae and Freddie Mac. Unlike the other housing GSEs, the FHLBank System is a cooperative made up of twelve independent FHLBanks with joint and several liability. The FHLBanks, out of the proceeds from net income, operate statutorily mandated affordable housing programs and are responsible for paying off the RefCorp bonds that were used to help resolve the 1980s savings and loan losses. Each FHLBank is primarily capitalized through the required purchase of stock by its member institutions. FHLBank stock is not available to the public and is

not tradable, even within a FHLBank, without the express permission of the FHLBank. The stock is issued and redeemed at a par value of \$100 and does not fluctuate in value.

As the debate over the appropriate regulatory scheme for the FHLBank System develops, I cannot stress strongly enough the importance of maintaining the cooperative nature of the Federal Home Loan Bank System under a new structure of regulation and supervision of the System and the housing GSEs. The cooperative structure of the System is essential to preserving the benefits that member institutions provide to communities and families and fund through advances. One of the many strengths of the System is the ability of each of the 12 Banks to develop and tailor products that meet the changing and diverse needs of their own members. Advances are used to fund loans that may not be conforming loans that the member institution may retain in portfolio. The AMA programs also have provided a needed outlet to community banks.

The FHLBank System needs a strong, independent regulator that has the authority to supervise the individual Banks using the current statutory framework of powers. Any new regulator of the FHLBanks must have the authority to maintain the Banks' access to the capital markets and their current well-defined mission to support the mortgage finance, affordable housing, and community development activities of member banks. The advance programs of the FHLBanks ensure that homebuyers and others in the community have ready access to home mortgage and community financing through FHLBank members. The fact that the FHLBank System members are the leading lenders to lower income and minority borrowers is testament to the success of the System and its mission.

The regulator must be flexible and equipped to address the differences in the business and operation among the Banks. The new regulator must also work within the current statutory authorities, which include safety and soundness and mission oversight. It is also critical that the financial obligations imposed on the Banks by Congress are able to be met.

In 1989, two assessments were placed on the earnings of the System. The first, the Affordable Housing Program ("AHP"), is funded out of contributions from the net income of each FHLBank. The total contribution from all FHLBanks is required to be a minimum of \$100 million or 10 percent of earnings each year. This money is then allocated based on an application process developed by the FHFB. The projects that receive funding include many housing and community development projects. This program is a good example of how special affordable housing and community partnerships can be funded by an assessment on the System. I strongly support the very successful AHP as it is structured and would not support any changes.

The second assessment on the System is the obligation toward repayment of the interest on the RefCorp obligations. Each bank must pay an amount equal to 20 percent of net earnings to repay the obligations incurred in the 1980's. These assessments are a legacy obligation of the System and are part of obligations which Congress imposed on the System, along with other mission requirements. This costly obligation will not expire until 2030.

Congressional efforts to strengthen the regulation of the FHLBank System are important, but it is important to recognize that improvements in regulation are expected primarily from synergies and expertise that should be available in a new regulatory structure. The current regulator has

broad powers to promulgate and enforce all regulations and orders necessary to ensure that safety and soundness and mission requirements are fulfilled. It is important that the new regulator effectively exercise this authority to ensure the safe and sound operation of the Banks and to preserve the core mission of the System of providing liquidity to community banks. The characteristics for any new regulator must include that the regulator:

- Be independent and not subject to the Congressional appropriations process;
- Be funded in a manner that provides that the System's assessments be allocated predominately to the regulation and supervision of the System;
- Possess similar supervision and enforcement powers to those of federal banking regulators to maintain safety and soundness and guard against systemic risk;
- Be organized with a strong emphasis on preserving the current statutory authorities and the cooperative structure of the System;
- Recognize the unique characteristics of the System; and
- Not impede or limit the FHLBanks' access to the capital markets.

The independence of the future regulator is an important element. A structure that provides autonomy will insulate the regulator from concerns about unintended political influence. The ability to fund operations without having to resort to the annual Congressional appropriations process is critical. In addition, the assessments that the regulator makes on the FHLBanks must be used to examine and supervise the FHLBanks.

The FHFBB has powers and authorities similar to those of the banking regulators in the areas of capital, activities and supervision. Such authorities should be preserved and to the extent that efficiencies can be gained by combining supervision in discreet areas, the regulator must recognize the differences in the regulated entities. Substantive areas in which there may be synergies include interest rate risk management and accounting guidance.

A review of the structure and power of the regulators is important. It is also critical that as the System evolves, the regulator, the members, the analysts, the purchasers of the debt and other interested parties be able to have access to information about the Banks.

The FHLBanks' stock and debt instruments should be subject to transparent disclosures that are appropriate for this unique GSE. In June 2004, the FHFBB issued a final rule requiring that each Federal Home Loan Bank register a class of securities with the SEC under the Securities Exchange Act of 1934. The disclosure scheme that has been established for public companies contains a number requirements with which it is difficult for a cooperative System to comply. I support the inclusion of certain specific securities law exemptions in any legislation. Such exemptions will make it easier for the FHLBanks to register and comply with the disclosure requirements, but will also make it easier for interested parties to understand the disclosures and the business of the FHLBanks. In particular, I support a specific provision that would exempt the FHLBanks and the System from certain requirements of the SEC's Regulation FD.

As part of SEC registration, each of the Banks must comply with a number of provisions of the Sarbanes Oxley Act, including Section 404. Each FHLBank is developing the systems, policies and procedures necessary to comply with the internal control requirements. In addition, each

FHLBank is drafting disclosures that must be included in the registration statements regarding financial information, operations and corporate governance. Each FHLBank is ensuring that its staff has the expertise necessary to draft the disclosures and to meet regulatory requirements.

Going forward, the public nature of the disclosures and the transparency that results from the ongoing reporting requirements will result in a better understanding of internal controls, corporate governance, and financial condition of each of the FHLBanks and the System as a whole.

The current corporate governance structure of the FHLBank System has been established by statute. Over the years certain governance functions have been devolved from the regulator to the FHLBanks themselves. I believe that the composition of the Boards of the each of the FHLBanks is a critical element in ensuring that the governance of the FHLBank is undertaken in an appropriate manner. As each of the FHLBanks, and the System in general, has evolved into more sophisticated financial institutions, I believe that financial, business and operating expertise must be demonstrated by the Board of each FHLBank. I support careful consideration of changes to the statute, regulation, and practice that will ensure that each FHLBank will have a Board that is composed of members with a stake in the System who understand the commitment and importance of serving on a FHLBank Board. As the financial structure of the Banks becomes increasing complex, it is important to have strong financial qualifications for all directors so that they can effectively oversee the FHLBanks' operations.

I wish to again express my appreciation for this opportunity to testify on this important issue. The future of the FHLBank System is important to the day to day operations of many community banks, including Acacia and communities they serve. I look forward to working with you and the members of the Subcommittee as the legislative process unfolds.

**Hearing of the Subcommittee on Capital Markets, Insurance and
Government Sponsored Enterprises
March 8, 2005**

**Testimony of Jan A. Miller
President and CEO, Wainwright Bank – Boston, Massachusetts**

Thank you for this opportunity to testify before the Subcommittee this morning on the Federal Home Loan Bank System. My name is Jan Miller, and I'm President and CEO of Wainwright Bank & Trust Company in Boston. I also serve as an elected director on the board of the Federal Home Loan Bank of Boston.

Wainwright is a \$750 million socially responsible commercial community bank with 9 branches throughout the metropolitan Boston area. The Bank's progressive agenda includes a commitment to affordable housing, community development, social justice, environmental issues, women's rights and the gay and lesbian community. We take pride in our mission of socially responsible banking, and we're equally committed to all our stakeholders, including employees, customers, and the communities and shareholders we serve. The 22 languages spoken among the employees at the bank reflect the diversity of the communities we serve. It is our commitment to affordable housing and community development that is a cornerstone of the organization. We have provided over \$400 million in financing for these over the last decade. Currently approximately 40% of our commercial loan portfolio is to community development and non-profit lending, including homeless shelters, special needs housing, food banks, AIDS

housing and services, breast cancer research, wilderness preservation, community health centers, and other service organizations.

I ran for a seat on the Boston Bank's board because the Federal Home Loan Banks are a critical partner for community banks like Wainwright. We rely on the Federal Home Loan Bank of Boston as a vital source of liquidity and asset-liability management.

But equally important, the Boston Bank has been enormously helpful in our efforts to address the need for affordable housing in the extremely dense, high-cost metropolitan Boston area. Each Federal Home Loan Bank commits 10 percent of its net profits to the Affordable Housing Program, which awards grants and subsidized, below market-rate loans to fund affordable-housing developments for very low-, low-, and moderate-income individuals and families. Wainwright has been fortunate enough to win funding for 24 such projects. We simply could not have funded these developments — which have resulted in 775 units of much needed housing — without the nearly \$6 million in AHP grants and \$12 million in subsidized advances. Whether it's transforming an empty city school into affordable assisted living for the elderly, or creating first-time homeownership opportunities for hardworking families, or providing quality housing for special-needs populations, the homeless, and the disabled, the Affordable Housing Program has been an important vehicle for Wainwright to fulfill its mission and strengthen our community relationships.

In addition to the subsidized advances we have used more than \$60 million in other term advances to assist us in providing financing for the construction of more than 2,000 other units of

housing throughout the Boston area. We would not have been able to provide long term fixed rate financing without the FHLB Boston.

The Federal Home Loan Banks are as relevant today as they were when Congress created the Bank System in 1932. If the members of the Subcommittee believe it is important for this nation to have diverse, locally based financial institutions serving our communities, and not just a handful of very large banks, then it is vital that we keep the Federal Home Loan Bank System strong and vibrant. Moreover, if you believe as I do, that private financial institutions have a key role in addressing the tremendous need for affordable housing across the nation, the Federal Home Loan Banks are critical.

Congress was wise to establish the Bank System as a regionally based cooperative. The Federal Home Loan Banks are well positioned to meet the unique needs of the multifaceted communities in our nation. The housing and community-development-finance needs could be very different in New England than those one would find in Chairman Baker's district in Louisiana, or in Ranking Minority Member Kanjorski's district in Pennsylvania. The local Federal Home Loan Bank knows the laws and regulations and also the people in the public sector and who to turn to for assistance. They are attuned to any changes or new requirements. The people at the Federal Home Loan Bank of Boston are committed to affordable housing and become our partner in the project. The Affordable Housing Advisory Council brings members of the housing community together frequently to discuss issues, the Bank's programs and the needs within the region. It is my belief that the Bank System would not be nearly as effective if it were a "one size fits all" operation.

The directors of the Boston Bank have considered at some length the potential for reforming the regulatory structure for the Federal Home Loan Banks, along with Fannie Mae and Freddie Mac. As a director and a shareholder, I support having a strong and respected regulator for the Federal Home Loan Banks.

The Boston Bank, as a member of the Council of Federal Home Loan Banks, supports the guiding principles for legislative reform Mr. Hehman has described in his testimony. More specifically, the board of directors of the Boston Bank believes any GSE reform legislation should have the following elements:

- The new regulator must be independent, outside of the Department of the Treasury, and dedicate a separate division to oversee the Federal Home Loan Banks.
- Independent directors must continue to be appointed to the boards to maintain representation of the public interest. Directors from outside the industry have brought great value to the Banks, and can provide expertise that is extremely useful, given the current environment and sophistication of the Banks.
- And we believe the current cap on director compensation must be removed in order to retain and attract qualified directors, particularly in light of the increased demands and responsibilities placed on them. I applaud the members of the Financial Services

Committee for addressing this issue in the regulatory relief bill during the last session of Congress.

Finally, the Boston Bank would strongly oppose the following in any GSE reform legislation:

- We would be against any efforts aimed at minimizing the Banks' current GSE status that could lead to privatization.
- We would oppose any provisions aimed at fostering consolidation in the System.
- We would not support the imposition of additional financial burdens on the Banks. As cooperatives, the Federal Home Loan Banks already operate on very narrow margins.
- We believe the Federal Housing Finance Board has sufficient authority to oversee the safety and soundness of the System's mortgage-purchase programs, and thus would oppose any limits placed on these programs by legislation.
- We would also oppose any limits placed on large members' access to the Banks. Large members give the Federal Home Loan Banks the critical mass necessary to be a strong partner to smaller financial institutions and an important source of affordable-housing financing.

- We firmly believe that directors of the Federal Home Loan Banks need to have the same authority as directors at any other company, as a matter of good governance. Thus we would strongly oppose any restrictions on board governance that were granted in Gramm-Leach-Bliley.

Mr. Chairman, I appreciate this opportunity to testify this morning. On behalf of Wainwright Bank and the Federal Home Loan Bank of Boston, I look forward to working with you and your colleagues to craft a sound and thoughtful regulatory structure for the Federal Home Loan Banks.

**Testimony of Ronald A. Rosenfeld
Chairman, Federal Housing Finance Board
Before the Subcommittee on Capital Markets, Insurance and
Government Sponsored Enterprises
March 9, 2005**

Thank you, Chairman Baker, Ranking Member Kanjorski, and members of the subcommittee.

Today represents my first appearance before this subcommittee. I am honored to appear before you, and I thank you for the opportunity to discuss the Federal Home Loan Bank System and reform of the government sponsored enterprises (GSEs).

The opportunity to serve at the Finance Board is a great privilege. It has also been my privilege to work in the public sector at both the state and federal level, and most recently, as president of Ginnie Mae. I have also spent a good part of my career in the real estate development and investment banking businesses. As Chairman of the Finance Board, I testify today as a regulator who is committed to ensuring that the Banks operate in a financially safe and sound manner, and carry out their housing finance mission.

The 12 Federal Home Loan Banks are owned by their members -- more than 8,000 financial institutions -- primarily commercial banks, savings associations, insurance companies, and federally insured credit unions. The Banks serve the public by promoting the availability of housing finance, primarily by providing low-cost loans, commonly known as "advances," to their members.

Mr. Chairman, I would like to begin by providing this subcommittee with an update on the Banks registration with the Securities and Exchange Commission (SEC). The Banks are required to file registration statements by

no later than June 30, 2005, and to have their registrations effective by no later than August 29, 2005.

Finance Board staff has been working with the Banks to ensure that registration is accomplished in a smooth and efficient manner. Over the past year, the Finance Board issued three Advisory Bulletins to the Banks to help guide them through the registration process. To date, ten of the Banks have filed draft Form 10s with the SEC and nine of those Banks have received comment letters from the SEC.

On the supervisory front, last year, the Finance Board entered into two supervisory “written agreements” — one with the Federal Home Loan Bank of Chicago and the other with the Federal Home Loan Bank of Seattle.

The Finance Board’s written agreement with the Federal Home Loan Bank of Seattle, issued in December 2004, addresses shortcomings in the Bank's corporate governance, risk management, and financial performance. For several years, the Seattle Bank had been seeking growth and profitability by building a portfolio of purchased mortgage loans and mortgage-backed securities to supplement earnings from its advance business. As so often happens during periods of rapid growth, the Seattle Bank paid less attention to sound risk management practices than it should have.

Under the written agreement, the Finance Board required the Seattle Bank to hire independent third parties to conduct reviews of board and management oversight and the Bank’s risk management processes. Those reviews are under way. In addition, the Finance Board required the Bank to provide it with an acceptable three-year business and capital management plan.

In considering its strategic alternatives, the Bank’s Board of Directors and senior management have decided to focus on the company’s traditional mission assets, called “advances.” They are developing strategies, subject to Finance Board review, that will be designed to improve the Bank’s long-term financial position by decreasing its exposure to interest-rate fluctuations. This will likely include the development of an exit strategy for the Mortgage Purchase Program, which will enable the Bank to lower its overall risk profile and reduce its operating cost structure.

Previously, in June 2004, the Finance Board entered into a written agreement with the Federal Home Loan Bank of Chicago. That agreement addressed various shortcomings in the Bank's governance, risk management, internal audit, capital management, accounting, and financial recordkeeping practices. Last month, the Finance Board accepted the Bank's three-year business and capital plan. The agreement also called for the Bank to maintain a 5.1 percent capital ratio and to engage an independent third-party to review the Bank's management and board governance, as well as the Bank's risk management, accounting, internal audit, and financial recordkeeping practices.

At the Finance Board we are continuing to assess the performance and condition of these two Banks. We are monitoring their progress in addressing their deficiencies. And, I can assure you, that we will take whatever additional measures, if any, are needed to maintain the safety and soundness of each of the Federal Home Loan Banks and the System as a whole.

Now, let me summarize briefly four key supervisory initiatives and priorities for 2005 and offer a brief comment on GSE reform.

First, interest rate risk monitoring is at the top of our supervisory agenda. Interest rate risk is an inherent and significant risk facing the Banks owing to the nature of their business. Last year, we issued Advisory Bulletin 04-05, *Interest Rate Risk Management*, which describes supervisory expectations for the prudential management of interest rate risk.

As a follow up to that bulletin, we recently began requiring the Banks to submit to the Finance Board quarterly reports that show the Banks' market value estimates of assets, liabilities, and shareholders' equity under a range in interest rate scenarios.

To further buttress our interest rate risk program, this year we will expand our use of risk modeling technology to measure "off-site" the interest rate risk of the mortgage portfolios of each of the 12 banks.

Second, this year we initiated a program to visit each Bank, on a quarterly basis, between our annual on-site examinations. These visits are conducted by the examiner-in-charge of each Bank and one or two other staff members. The visits give us the opportunity to follow-up on examination issues and other developments, including the Banks progress in responding to regulatory initiatives such as SEC registration.

Third, we have directed our examiners to place increased emphasis on two essential elements of sound banking: corporate governance and risk management. In addition, our examiners will continue to give close scrutiny to the accounting practices, particularly the hedge accounting practices of the Banks.

And fourth, we intend to provide additional guidance in with respect to the Affordable Housing Program, particularly with respect to the operation of the homeownership set aside program. A report summarizing key findings from our review of the program will be available shortly.

Finally, regarding reform of the housing GSEs, there can be little debate over the need to have the very best supervision and regulation. On that, I suspect we can all agree. So, the issue comes down to whether there will be real GSE reform. Real GSE reform consists of equipping the regulator with the powers that are most critical to providing effective and thorough oversight. In my view, a regulator must have a complete arsenal of enforcement powers, including but not limited to, freedom from the appropriations process, the authority to approve new business activities, and receivership authority. As for the structure of the regulator, the Administration has spoken in its 2006 budget, and a clear consensus has emerged in support of one regulator.

I would note, however, that there are fundamental differences between Fannie Mae and Freddie Mac on the one hand, and the FHLBanks on the other. For example, Fannie Mae and Freddie Mac are shareholder-owned enterprises that focus on providing credit guarantees on pools of mortgages. They are in the mortgage securitization business, which they conduct on a nationwide basis. In contrast, the Federal Home Loan Banks are regionally based, member-owned, cooperatives that provide low-cost financing to their members. They do not securitize mortgages. Those differences should be accommodated.

Chairman Baker, Ranking Member Kanjorski, and members of the subcommittee, thank you for this opportunity. I would be pleased to answer your questions.



FEDERAL HOUSING FINANCE BOARD
Office of the Chairman

March 17, 2005

The Honorable Richard H. Baker
Chairman
Subcommittee on Capital Markets, Insurance
and Government Sponsored Enterprises
2129 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Baker:

In response to members' questions at the March 9th hearing entitled, "GSE Reform and the Federal Home Loan Bank System," I respectfully submit the enclosed responses. They address questions raised by Congresswomen Wassermann-Shultz and Velázquez and Congressmen Feeney and Fitzpatrick.

Thank you for the opportunity to offer my thoughts on the important issues involved in the regulation of the government sponsored enterprises, including the Federal Home Loan Banks. Please know that I share your commitment to strong, capable, and consistent regulation of the housing GSEs overseen by the Federal Housing Finance Board, and I remain at your service as the subcommittee continues its work in this area.

Sincerely,

A handwritten signature in black ink, appearing to read "Ronald A. Rosenfeld".

Ronald A. Rosenfeld
Chairman

Attachments

**FEDERAL HOUSING FINANCE BOARD
APPOINTMENTS OF FHLBANK DIRECTORS**

The board of directors of each Federal Home Loan Bank (FHLBank) is made up of two classes of directors. One class is elected by the members of the FHLBank, and the other class is appointed by the Federal Housing Finance Board (Finance Board).

By statute, the elected directors at each FHLBank constitute a majority of the board of directors, while the appointed directors constitute a minority. The "baseline" board size for each FHLBank is fourteen, with eight elected directors and six appointed directors, although certain provisions of the statute have resulted in most FHLBanks having slightly larger boards.

All directors currently serve for a term of three years, and the terms are staggered so that approximately one-third of the directorships are filled each year. All terms commence on January 1st of each year.

As is shown on the accompanying table, since 1996, the Finance Board has twice completed the process of appointing FHLBank directors before the first board meetings of the new year occur, which typically is in January.

In December 1997, the Finance Board appointed individuals to fill all of the 15 directorships that were to commence on January 1, 1998.

In December 2000, the Finance Board appointed individuals to fill all 18 of the appointed directorships whose terms were to commence on January 1, 2001.

In all of the following years, the Finance Board completed the appointment process sometime between January and March of that year.

For the 12 appointed directorships that were to be filled as of January 1, 1996, the Finance Board filled 11 directorships on March 21, 1996, and filled the remaining one directorship on July 19, 1996.

For the 17 appointed directorships to be filled as of January 1, 1997, the Finance Board appointed 16 persons to fill those seats as of January 13, 1997, and appointed the remaining person on February 5, 1997.

For the 34 appointed directorships to be filled as of January 1, 1999, the Finance Board appointed 6 persons on January 6th, 5 persons on January 20th, and 23 persons on January 27, 1999.

For the 29 directorships to be filled as of January 1, 2000, the Finance Board filled 3 of those seats on December 20, 1999, 23 seats on January 14, 2000, and the remaining 3 seats on February 7, 2000.

For the 36 directorships that were to be filled as of January 1, 2002, the Finance Board filled all of those open seats on March 6, 2002.

For the 29 directorships that were to be filled as of January 1, 2003, the Finance Board appointed 28 individuals to those directorships on January 29, 2003, and appointed the remaining person on March 12, 2003.

For the 24 appointed directorships that were to be filled as of January 1, 2004, the Finance Board appointed individuals to fill all of those open seats on January 23, 2004.

**FHLBanks' Public Interest Director Appointments
Approved by the Finance Board**

Year of Appointment Effective January 1	Seats to be Filled	Date of Resolution	Number of Appointments Approved
1996	12	March 21, 1996	11
1996		July 19, 1996	1
1997	17	January 13, 1997	16
1997		February 5, 1997	1
1998	15	December 30, 1997	15
1999	34	January 14, 1999	6
		January 20, 1999	5
		January 27, 1999	23
2000	29	December 20, 1999	3
		January 14, 2000	23
		February 7, 2000	3
2001	18	December 20, 2000	16
		December 29, 2000	2
2002	36	March 6, 2002	36
2003	29	January 29, 2003	28
		March 12, 2003	1
2004	24	January 23, 2004	24
2005	29		

**FEDERAL HOUSING FINANCE BOARD
EXPANDING THE REACH OF THE AFFORDABLE HOUSING PROGRAM**

What are your thoughts on the Banks' reaching more families by increasing the AHP threshold to 30 or 40 percent of units and serving poorer families by lowering the area median income ("AMI") maximum to 40 or 30 percent?

By statute, AHP subsidies support homeownership by families with incomes at or below 80 percent of AMI and rental housing in which at least 20 percent of units will be affordable for households with income at or below 50 percent of AMI. By regulation, however, additional preferences are given to rental projects with 60 percent of units reserved for occupancy by households with incomes at or below 50 percent of AMI. Therefore, the Finance Board's AHP regulation already establishes a 60 threshold for the percent of units serving very low-income households, which exceeds the 30 to 40 percent suggested in the question.¹

In fact, as shown in the following table, 70 percent of units receiving subsidies in the AHP Competitive Application Program since its inception were reserved for "very low-income" individuals or families – those with income no greater than 50 percent of the median income for the area.

AHP Competitive Application Program Approved Applications Very Low Income Units Receiving Assistance		
	2004	1990-2004
Total Units	31,681	380,960
Very Low Income	22,040	268,215
Owner-Occupied	7,019	102,810
Very Low Income	3,524	58,041
Rental	24,662	278,150
Very Low Income	18,516	210,174

The AHP regulation does not explicitly distinguish between households with incomes at 50 percent of the median for the area and those with incomes below that level, such as 40 or 30 percent of AMI. However, the AHP regulation has at least two provisions that

¹ 12 CFR §951.6(b)(4)(iv)(C)(1) states: "An application for a rental project shall be awarded the maximum number of points available under this scoring criterion if 60 percent of more of the units in the project are reserved for occupancy by households with incomes at or below 50 percent of the median income for the area. Applications for projects with less than 60 percent of the units reserved for occupancy by households with incomes at or below 50 percent of the median income for the area shall be awarded points on a declining scale based on the percentage of units reserved for households with incomes at or below 50 percent of the median for the area."

would allow a Federal Home Loan Bank (“Bank”) to target poorer households for AHP subsidies. First, one of the scoring criteria used to award AHP grants under the competitive program is “Housing for Homeless Households.” Projects in which at least 20 percent of rental units are reserved for homeless households for a minimum occupancy of six months or in which at least 20 percent of permanent owner-occupied housing is reserved for homeless households receive credit under this criterion. Second, each Bank must establish a district priority that satisfies a housing need in the Bank’s district as defined and recommended by the Bank’s Affordable Housing Advisory Council and adopted by its board of directors. In districts in which housing for families with incomes of 30 to 40 percent of AMI is a particular need, the Banks can, *and should*, include this need as a district priority.

FEDERAL HOUSING FINANCE BOARD
PURCHASERS OF FEDERAL HOME LOAN BANK CONSOLIDATED OBLIGATIONS

What is the distribution of Federal Home Loan Bank ("Bank") Consolidated Obligations among domestic and foreign purchasers? What share of the Consolidated Obligations is purchased by foreign central banks?

On behalf of the Federal Home Loan Banks, the Office of Finance (the "OF") issues bonds and discount notes. Bonds have a maturity of one year or longer and discount notes have a maturity of less than one year.

The global bond program is the only one for which the OF obtains information about the initial distribution of bonds. Global bonds are usually syndicated fixed-rate bonds sold as part of offerings of \$3 billion or more. About 10 percent of the bonds issued in 2004 were global bonds. Domestic and foreign investors purchase global bonds. Domestic accounts are thought to purchase the vast majority of non-global bonds. The principal differences are (1) the global offering documents are more tailored to foreign investors and (2) only global bonds are sold in large syndicated deals.

In 2004, the Federal Home Loan Banks issued \$40.58 billion in global bonds. The distribution of those bonds by region and by type of investor is presented in the following tables.

Distribution of Syndicated FHLBank Global Bonds by Region		
2004		
Region	Dollars (Millions)	Percent
United States	\$19,436	47.9%
Asia	14,719	36.3
Europe	4,050	10.0
Other	2,375	5.9
TOTAL	40,580	100.0

Distribution of Syndicated FHLBank Global Bonds by Investor		
2004		
Investor	Dollars (Millions)	Percent
Central Banks	\$14,540	35.8 %
Investment Advisors	11,766	29.0
Financial Institutions	6,689	16.5
Pension Funds	2,150	5.3
Other Government	1,437	3.5
Corporations	896	2.2
Individuals	284	0.7
Other	2,818	6.9
TOTAL	40,580	100.0

**FEDERAL HOUSING FINANCE BOARD
FEDERAL HOME LOAN BANK SYSTEM CAPITAL**

What is the leverage ratio of capital to assets in the Federal Home Loan Banks?

The Federal Home Loan Bank Act establishes that a Federal Home Loan Bank's total capital shall not be less than 4 percent of the total assets of the Bank. As of December 31, 2004, the System ratio of capital to assets was 4.5 percent. The capital ratios for the individual Banks ranged from 4.1 percent to 5.4 percent.

How many Banks have converted to their new capital structure plans?

The Finance Board approved new capital structure plans for all 12 Banks in 2002. Ten of the 12 Banks have converted to their new capital structures. The New York Bank is scheduled to convert before the end of this year. The Chicago Bank plans to convert before the end of 2006.