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Testimony of

Raymond R. Christman
President and Chief Executive Officer
Federal Home Loan Bank of Atlanta

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Good Morning Chairman Shelby, Ranking Member Sarbanes, and Members of the Committee, I am Ray Christman, President and CEO of the Federal Home Loan Bank of Atlanta, and I speak to you today on behalf of the Council of Federal Home Loan Banks (Council). I appreciate the opportunity to participate in this important discussion about legislation to reform the regulation of the housing Government Sponsored Enterprises (GSEs), including the Federal Home Loan Bank System.

At the outset, I would like to commend Chairman Shelby and Ranking Member Sarbanes for your dedication to the task of ensuring that the GSEs have a truly world-class regulator with the necessary authority to enable the GSEs to fulfill their important missions in a safe and sound fashion. I would also like to commend the other Members of this Committee, including Senators Hagel, Johnson, Dole, Bayh, and Sununu, for their efforts to achieve this important public policy goal. The Council is supportive of legislative efforts toward enactment of meaningful GSE regulatory reform legislation this Congress.

The Federal Home Loan Bank System – A Unique Cooperative Business Model

Congress created the Federal Home Loan Banks (FHLBanks) in 1932 to stabilize and increase the availability of funds to support home ownership through their member thrift institutions. Although initially capitalized with government funds, member banks have contributed all of the FHLBanks capital for over 50 years. With the expansion of membership 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 FHLBanks and their members (federally insured savings associations, commercial banks, credit unions, and some insurance companies) are now the largest source of residential mortgage and community development credit in the United States.

Although the Federal Home Loan Bank System (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 System is unique, comprised of 12 regional FHLBanks, 8,100 member financial institutions and the Office of Finance that issues debt on behalf of the FHLBanks.

The regional FHLBanks are overseen by an independent regulator, the Federal Housing Finance Board (Finance Board). The structure forms a cooperative business model, driven by customer credit demand. In addition, while the 12 FHLBanks are independently owned and operated, they share joint and several liability for the System's debt.

No other housing GSE operates under a similar decentralized, regional structure. Owners of the System are also its members and the primary users of its services. As a cooperative:

- the FHLBanks issue no publicly traded equity stock.
- the FHLBanks' member contributed capital, which capitalizes the Bank System, does not trade on any market and does not fluctuate in value.
- no FHLBank officer or director receives any stock options or any stock related compensation; thus there is no incentive to manage or manipulate earnings in order to reap the benefit of options.

As a result, the return on equity profile of the FHLBank System is very different from that of Fannie Mae and Freddie Mac, which, as public companies, face public stockholder demands for return on equity. The FHLBank System had a return on average equity of 4.49% as of December 31, 2004, and the return on equity profile has historically remained much lower than publicly traded companies. For many members, the largest single investment on their balance sheet is their FHLBank stock – making the FHLBank's safe and sound operation a matter of paramount importance to them.

Capital Structure and Requirements

Before passage of the Gramm-Leach-Bliley (GLB) Act in 1999, the FHLBanks were subject to a subscription-style capital structure under which voluntary FHLBank members, such as commercial banks, could withdraw their capital on 6-months notice. The GLB Act increased the capital strength of the FHLBanks by providing for a voluntary membership system in which institutions that chose to become members of an FHLBank are required to invest more permanent stock in their FHLBank. The legislation replaced the subscription-style capital model with a leverage requirement (minimum capital-to-asset ratio) of 4 percent as well as a risk-based capital standard. (The risk-based capital standards take into account credit risk, interest-rate risk and operations risk.)

Total FHLBank System capital was $41.8 billion at the end of 2004, a 7.1 percent increase from the previous year, and now stands at a capital to assets ratio of 4.5 percent.

The GLB Act also required each FHLBank to submit a capital plan to the Finance Board for review and approval. The Finance Board approved all 12 plans by 2002, and 10 of the 12 plans have been implemented. The remaining two plans (Chicago and New York), are due to be implemented by the end of 2006.

The new FHLBank capital plans create more permanent capital by substantially reducing, and in most cases eliminating, the obligation under the subscription-style capital structure to redeem capital stock six months after a member elects to withdraw. The six-month election period is replaced with a five-year withdrawal period. The legislation includes additional provisions to ensure that FHLBank capital is not reduced by redemptions in times of stress by prohibiting capital withdrawals that would result in an FHLBank falling below the minimum capital level of 4 percent.

If this is not sufficient, the FHLBank can obtain additional capital from its members until it exceeds the minimum capital ratio; the regulator may also prompt an FHLBank to seek capital from its membership. In addition, the Finance Board has broad authority to address problems at a financially distressed FHLBank, including the ability to liquidate or consolidate that institution.

Joint and Several Liability

One of the key strengths of the Federal Home Loan Bank System is that debt issued on behalf of one FHLBank is the joint and several liability of all twelve banks. This shared responsibility both enhances the safety and soundness of the System and contributes to its triple-A credit rating. As a result of the System's joint and several liability, the FHLBanks are able to access the capital markets on a combined basis and deliver wholesale funding to their members at capital market rates.

In July 2001, GAO noted in its report on the FHLBanks' new capital structure that:

- *"Joint and several liability for the payment of consolidated obligations gives investors confidence that System debt will be paid."*
- *"Another related characteristic of joint and several is that it potentially creates a large pool of capital from all FHLBanks to provide a cushion in the event of unexpected System losses."*[i]

Joint and several liability strengthens the FHLBank risk management structure, resulting in lower borrowing rates for FHLBank members. Those savings are passed on to homebuyers, small businesses, and farmers -- the end users of debt raised by the FHLBank system – in the form of lower borrowing costs.

Evolution of the FHLBank System

From its inception with the passage of the Federal Home Loan Bank Act in 1932 until 1980's, the FHLBank System underwent few changes. The FHLBank Act, established to counter the effects of the Great Depression on the mortgage credit and housing finance market, required all federally chartered thrifts to become members of the FHLBank in their district and invest capital in their FHLBanks. Acting as a central credit facility, the FHLBank System made advances to thrifts, which in turn made mortgage credit available to the housing mortgage market.

The System served its role as a low cost funding source to help overcome regional credit shortages and disparities. After the thrift crisis of the 1980's and the enactment of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), which allowed commercial banks and credit unions to become members, the FHLBank System underwent substantial evolution in the 1990's, which continued with the passage of the Gramm-Leach-Bliley Act of 1999.

Thanks in large part to the work of Senators Hagel, Johnson and Bayh to include Federal Home Loan Bank modernization in the Gramm-Leach-Bliley Act of 1999, Title VI of that Act established universal voluntary membership for the FHLBank System; 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.

As result of these legislative developments as well as Finance Board rulemaking, the FHLBank System has undergone substantial change since 1990. While thrifts accounted for nearly 100 percent of membership in 1990, commercial banks now represent more than 70 percent of System membership. The composition of FHLBank System assets has also varied.

Although advances remain the largest asset, advances declined from about 70 percent of the System's assets in the early 1990's to about 50 percent in the mid-1990's as the FHLBanks increased investments in mortgage backed and other types of securities. Investments as a percentage of all the System's assets began to decline in 1995, while advances grew. From 1997 to 2003, FHLBank System mortgage holdings increased as a percentage of assets, relative to advances and investments, and leveled off in 2004. Today, advances account for 63 percent of assets, while mortgages account for 12 percent, and other investments and capital round out the remaining 25 percent of the composition.

The GLB Act also altered the corporate governance structure of the FHLBanks by shifting the management of each FHLBank from the regulator to the individual boards of each bank. As a result, the FHLBanks develop business plans tailored to the specific needs of their membership and the communities they serve. With the Securities and Exchange Commission registration requirement, the responsibilities of FHLBank board members will increase, making it critical that FHLBanks attract and retain the most qualified and experienced individuals for their boards.

If I may digress for a moment, I want to address a critical matter of corporate governance that is affecting the FHLBank System.

A board director's corporate governance responsibilities are far greater today then they were even a year ago, and greater responsibility prompts greater liability as well as the need for more expertise and experience. It is important to have a combination of industry and outside directors on the boards of the FHLBanks. The outside, or public interest directors, bring independence, different experiences and often expertise that is vital to the good management of the FHLBanks.

As part of this legislative process, I would urge two things: First, if possible, establish a process where board vacancies are quickly filled with individuals that have the necessary knowledge and experience to effectively govern. Second, whether through the regulatory process or through legislation, a new method should be developed that gives the FHLBanks and their boards of directors a greater role in the process of choosing qualified candidates for outside directorships. The method should ensure that the right expertise is brought to the boards and that unnecessary breaks in director service do not occur. I also believe the ability to attract and retain qualified FHLBank board members would be greatly enhanced by adopting legislative changes to remove the statutory caps on director compensation and to extend director terms from three years to four years.

Risk Management

The legislative and regulatory changes that have led to the evolution of the FHLBank System over the past fifteen years have had a dramatic impact on risk management activity for the FHLBanks. FHLBanks are subject to a minimum 4.0 percent capital-to-asset ratio as well as a risk-based capital requirement. The FHLBanks minimize credit risk by over-collateralizing advances, limiting investments to highly rated securities, and establishing policies, procedures, and expertise that seek to limit risks in the mortgage purchase programs. No FHLBank has ever suffered a credit loss on an advance to its members in the System's 73-year history.

The FHLBanks, like many other financial institutions, must deal with risks from interest rates, prepayment of mortgage assets, funding, credit and other sources. The FHLBanks use 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. As part of this process, the FHLBanks use a variety of techniques to manage these risks, including 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, and strictly preclude any speculative use of these instruments.

The cooperative structure of the FHLBanks eliminates many of the incentives a publicly traded company might have to raise its risk profile 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.

SEC Registration

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.

The Council supports efforts to include exemptions in the GSE reform legislation that take into account the FHLBanks' cooperative structure and the need for an on-going regulatory consultative process with the SEC to avoid unnecessary disruptions to the System's access to the capital markets. While the FHLBanks already have 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.

FHLBank Member Loans

The FHLBanks have two principal lines of business, which result in two types of assets: member loans (advances) and mortgages held in portfolio.

Advances are low cost loans made by the FHLBanks to member institutions. They are over-collateralized loans backed by high quality assets that primarily consist of home mortgage loans. Advances provide an important source of liquidity to FHLBank member financial institutions, which in turn helps those members serve their customers. In recent years, the FHLBanks have developed and offered a variety of advances with specialized features tailored to the particular needs of member institutions.

FHLBank advances can serve as a source of funding for a variety of conforming and nonconforming mortgages that cannot be sold in the secondary market, and help to support housing markets focused on low- and moderate-income households.

Advances also provide funds to smaller lenders that lack diverse funding sources. These lenders may not have access to other funding alternatives - such as repurchase agreements, commercial paper and brokered deposits - that are available to larger financial entities. FHLBank advance products give these lenders access to competitively priced wholesale funding.

The FHLBanks also help members in asset/liability management by offering advances that are matched to the maturity and prepayment characteristics of mortgage loans. These advances can reduce a member's interest-rate risk associated with holding long-term fixed-rate mortgages. FHLBank members can also enter into interest-rate exchange agreements with their FHLBank to reduce exposure to interest-rate risk.

At the end of 2004, combined Advances—the total Advances distributed to members of the twelve FHLBanks—were $581 billion and represented 63% of assets.

FHLBank Mortgage Purchase Programs

The FHLBank mortgage programs were created in the late-1990s to give FHLBank members an alternative outlet to sell conforming mortgages. By adding additional competition and efficiency in the secondary mortgage market and giving lenders more alternatives, these programs help drive down the costs of mortgage finance and make the dream of homeownership a reality for more Americans.

All twelve FHLBanks have offered either the Mortgage Partnership Finance® (MPF®) Program or one of the four Mortgage Purchase Programs (MPPs) to their members as an alternative funding source for their conforming mortgages. The risk-sharing structure of the programs has proved popular with FHLBank member financial institutions. Members can sell mortgages to the FHLBanks while retaining the principal credit risk, avoiding guarantee fees.

Over 1000 commercial banks, thrifts, credit unions and insurance companies across the country have joined one of the programs, the vast majority of which are community banks. These lenders have used the programs to fund over 1 million mortgage loans, worth more than $175 billion. In a recent Federal Reserve study, the authors noted that the FHLBanks' mortgage programs "appear to give many institutions, including many smaller depositories, a viable method of effectively lessening, or perhaps even removing, the influence of regulatory capital requirements on the pricing of mortgage loan credit risks."[ii]

Currently, the FHLBanks combined hold about $114 billion of these assets on their balance sheets. The interest rate risk of these loans is managed according to conservative internal and regulatory risk limits. As volume of mortgage loan assets grows, substantial time, effort, and resources must be invested to build and further enhance risk management capabilities. Also, complementary risk-management structures, such as the MPF Shared Funding® program, were developed creating additional funding capacity for FHLBank members.

The FHLBank mortgage programs have become a valuable funding source for FHLBank member lenders. Their success demonstrates a strong desire among lenders for additional options in the secondary mortgage market. These programs are fully consistent with the FHLBanks' housing finance mission -- every dollar of program funding can be directly traced to a loan that helped a family buy a new home or lowered the cost of borrowing for their existing home.

It is the Council's view that the System's mortgage purchase programs are a mission-consistent activity developed in response to member demand and the programs introduced a viable alternative into the secondary mortgage market. There also is strong consensus among the FHLBanks that mortgage purchase programs should be viewed as a complementary and secondary line of business to our primary activity of providing advances. While each FHLBank will have its own view as to what part mortgages should comprise of their balance sheet, in overall terms it is modest relative to our major asset category, advances.

The programs have provided a second profitable line of business for the FHLBanks, in addition to the traditional core business of advances. Profits generated by the mortgage programs, just like profits generated by advances and other FHLBank business, are allocated to four areas.

A portion may be required to maintain retained earnings; twenty percent goes to the payment of the RefCorp obligation; $100 million or ten percent, whichever is greater, goes toward the affordable housing program; and the remainder is paid out in the form of dividends to the member/owners of the FHLBank System.

In the long term, our customer-owners will determine the future growth of the FHLBank mortgage programs, like all other FHLBank programs and products. As the programs grow in popularity and assets build, there must be an effective way to manage the interest rate risk. In that respect, the FHLBanks need to work closely with a new regulator to determine what mechanism is available to turn these assets into cash that can be invested back into the housing finance system.

The structure of the programs may continue to evolve as the FHLBanks explore techniques to liquefy mortgage assets and create additional capacity. But the essential benefits for FHLBank members are unlikely to change unless the members desire it.

Each FHLBank is especially focused on the need to manage the risks associated with these programs in a sophisticated and safe fashion. While the Council has taken no position on securitization, and the 12 Banks may have differing views on how to best manage these mortgages, I believe all Banks recognize the need to develop over time appropriate risk transfer methods with respect to these programs. I would personally hope the legislation would ensure that the new regulator has the authority and flexibility to address these questions.

FHLBank Affordable Housing Programs

FIRREA created the FHLBanks Affordable Housing Program ("AHP"). FIRREA also established the Community Investment Program (CIP) for the FHLBanks to provide funding for members in support of community and economic development activities.

Each of the twelve FHLBanks is required by statute to contribute at least 10 percent of its previous year's net earnings to the AHP, subject to a minimum annual combined contribution by the twelve banks of $100 million. These subsidies may be in the form of grants or below cost interest rates on advances from the FHLBank to member lenders.

The statute requires AHP subsidies to be used to finance homeownership by families with incomes at or below 80 percent of the median area income, or to finance the purchase, construction, or rehabilitation of rental housing in which at least 20 percent of the units will be occupied by and affordable for families with incomes at or below 50 percent of the area median income.

Additional preferences are given, by regulation, to owner-occupied projects with the highest percentage of units targeted to households with the lowest percentage of area median income, and to rental projects with 60 percent or more of the units reserved for households at or below 50 percent of area median income. Preferences are also given to rental projects with the highest percentage of remaining units reserved for households with incomes below 80 percent of area median income.

From a practical standpoint, FHLBank Atlanta has seen more than half of our Bank's AHP funding, based on scoring and preferences, going to projects that provide housing to families with incomes lower than 50 percent of the area median income. This population is often the hardest to reach with respect to creating affordable housing, and represent another reason why AHP is a tremendous benefit in addressing a diversity of housing needs.

A key point to this program is the degree of flexibility and ability to adapt to differing community needs across the country. AHP can be used to support a wide array of affordable housing projects – rental and owner-occupied as well as single-family and multi-family units. Unlike other housing assistance programs, AHP can be used for both housing rehabilitation and new construction, and can be used to augment other sources of funding by filling in gaps.

AHP funds are awarded through a competitive application program run by each of the FHLBanks as well as through a homeownership set-aside program established by the Finance Board. Since its beginning, the AHP has resulted in the FHLBanks having awarded approximately $2 billion in grants through their members, making it the largest private source of affordable housing support in the nation. Between 1990 and 2004, approximately 430,000 housing units for low- and moderate-income families have been created thanks to AHP. In 2004, FHLBank contributions to the AHP rose to $213 million, from $199 million in 2003, reflecting the increased level of earnings in 2004.

In addition the FHLBanks voluntarily have established and funded other housing, community and economic development initiatives through their members. Under the CIP, the FHLBanks lend to members at or below cost to finance loans to moderate-income households, and for commercial and economic development loans for low- and moderate-income households. AHP and CIP programs play an important role in helping FHLBank members meet their Community Reinvestment Act (CRA) responsibilities.

The value of the regionally based cooperative structure of the FHLBanks is evidenced in the community development programs of the FHLBanks. For example FHLBank Atlanta offers a number of programs. The CIP provides attractively priced funds, in the form of discounted advances, to member financial institutions, which are used to fund single-family mortgage-loans or commercial loans for multi-family housing for low- and moderate-income families. The Economic Development and Growth Enhancement Program (EDGE) provides below market-rate loans for community economic development projects that directly benefit low-income neighborhoods or families. These projects include services and facilities that every hometown needs, like health, child-care, recreational, commercial, industrial or commercial development projects and neighborhood redevelopment. Since this program began, more than 78 neighborhoods have benefited by receiving subsidy grants of more than $22 million. The Economic Development Program (EDP) offers longer-term funding that supports community economic development at interest rates from 5 – 22 basis points lower than regular advance rates. These funds are often used to fund multiple smaller loans or to match-fund larger loans.

FHLBank Atlanta also operates a predevelopment fund, a new markets fund, and offers technical assistance and training to community partners on a wide range of topics including grant applications, financial analysis and infrastructure development. FHLBank Atlanta also partners with Historically Black Colleges and Universities in the Southeast.

It is important to emphasize the point that the funds that are directed to affordable housing through AHP are significant. Even though it is mandated by statute, the FHLBanks invest at least ten percent (10%) of their net income to these low-income housing programs. However, the other economic development programs referenced that FHLBank Atlanta offer -- and similar ones offered by the other FHLBank -- are subsidized funds provided voluntarily by the boards of the twelve district FHLBanks.

During the process of considering GSE regulatory reform, there has been some discussion of the desirability of applying affordable housing goals, similar to those for the other GSEs, to the FHLBank advance programs. Taking such action could be counterproductive and could reduce the benefits FHLBank liquidity provides its members and the communities they serve. When you recognize that the vast majority of FHLBank members have their ability to borrow affected by their CRA ratings, that ten percent of the income generated by the FHLBank advance programs goes directly into the affordable housing program and that recent evidence suggests a positive correlation between FHLBank membership and the amount of mission related assets held on the balance sheets of those members – you recognize the FHLBanks' advance programs are already well designed to achieve the housing and community development mission of the FHLBank System.

The Role and Value of the FHLBank System in Providing Liquidity to Members

The FHLBanks play a critical role in providing liquidity to their member financial institutions in support of residential and community-based lending. They serve the needs of their members, especially community bank members, by providing a stable, low-cost and reliable source of short and long-term funding. For many FHLBank members that are small or medium-sized community banks, direct borrowing in the capital markets is not a viable option. By providing a vital source of wholesale funding to help members manage liquidity, loan demand, and interest rate risk, the FHLBanks enable members to remain independent and continue to serve the needs of their local communities.

As one 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 that are active in the System[iii].

Also, in a recent Survey of Community Bank Executives conducted by Grant-Thornton, 56 percent of respondents reported that they used FHLBank advances as a source of funding in 2004 and 63 percent expect to use them in 2005[iv]. These numbers confirm the importance of the FHLBank System to a broad base of community banks.

The 12 FHLBanks provide over $580 billion of advance funding to member institutions, serving the housing and community development needs of virtually every neighborhood in America. Flexibility of the FHLBank model has allowed for adaptation over time in response to changing financial industry conditions and market environments. 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.

While to date there has been little empirical research on how FHLBank advances are directly connected to mortgage and community development lending, recently conducted research sponsored by the Council displays a strong correlation between membership and advances to members holding a significantly higher share of their assets in housing and community development loans[v]. These findings confirmed those in an earlier study sponsored by the Federal Reserve Bank of Cleveland[vi].

The Council also sponsored research using 2003 Home Mortgage Disclosure Act (HMDA) data to examine the mortgage lending behavior of FHLBank members. This study found that FHLBank advances are an important source of mortgage market liquidity and that in 2003 FHLBank members had higher overall origination rates and higher minority origination rates than non-members[vii].

I request that these studies be placed in the record along with my testimony.

Guiding Principles for Legislative Reform

During the 108th Congress there were very serious legislative efforts to reform regulation of the GSEs, including the FHLBanks. In the fall of 2003, the Council adopted "Guiding Principles" for legislative reforms, which were unanimously supported by all twelve FHLBanks. The Council believes that these same principles also should apply to the regulatory reform legislation under consideration in the 109th Congress:

Preserve/Affirm the FHLBanks' Mission

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.

The mission is one of providing cost-effective funding (liquidity) to members for use in supporting housing finance and community and economic development. And this mission is in turn accomplished through our advance, mortgage purchase, and affordable housing programs. There has been discussion as to whether this legislation should include an explicit mission statement for the FHLBanks.

The Council believes that the mission is outlined currently in the FHLBank Act, as amended by FIRREA and Gramm-Leach-Bliley, but that it is embedded in various provisions of that Act, rather than expressed in a single section. If Congress were to deem it appropriate to articulate a new stand-alone mission statement, we would hope that it would reflect the full range of existing mission-related activities now contained in our statute and in our day-to-day operations.

Provide for a Strong, Independent Regulator

Second, it is critical that the legislation provide for a strong, independent regulator. This proposed 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.

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. A strong regulator is one that has the authority to determine minimum and risk-based capital levels for the regulated entities, and adjust them as circumstances warrant. A strong regulator is one that also has the authority to place the entities into receivership, should that become necessary. In addition to providing the new regulator with the necessary authority, it is also critical that the regulator be independent. The legislative proposals for GSE reform under consideration have generally focused on an agency headed by a single administrator with an advisory board with cabinet member representation – generally HUD and Treasury. In order to preserve the true independence of the agency, the advisory status of the board should be made explicitly clear.

Preserve System Funding

Third, it is critical that the legislation preserve the role and function of the Office of Finance in providing funding for the FHLBank System. Legislation adopted by this Committee last Congress and legislation introduced this year included provisions that would ensure that this important function is preserved.

It bears repeating, however, that any final 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. The Office of Finance function is used by the FHLBanks to access the capital markets for the purpose of meeting their members' funding and liquidity needs.

Maintain the Unique Regional Cooperative Structure / Devolution of Corporate Governance

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.

The regional cooperative structure of the FHLBank System has enabled the FHLBanks to serve the individualized needs of their members and their communities in a highly effective manner over the years, and should be continued.

Looking to the future, one of the biggest challenges facing the FHLBank System will be to ensure that the FHLBanks have the ability to attract and retain FHLBank board members with the necessary skills to properly manage these increasingly complex financial institutions. While the rapidly evolving and expanded responsibilities of corporate directors presents challenges to many financial institutions, in the case of the FHLBanks, there are additional issues.

There is a strong indication that Congress is likely to move away from appointed directors for the GSEs, including the FHLBanks. Whether through the regulatory process or through legislation, a new method should be developed that will give the FHLBanks and their boards of directors a greater role in the process of choosing qualified candidates for non-member directorships. It is important to have a combination of member and non-member directors on the boards of the FHLBanks. The non-member, or public interest directors, bring independence, different experiences and often expertise that is vital to the good management of the FHLBanks. It is also important to retain the present requirement for at least two public interest directors for each board, since these directors often bring a sometimes different and more diverse perspective that is beneficial to FHLBank board deliberations.

The ability to attract and retain qualified FHLBank board members would, in my opinion, be greatly enhanced by also adopting legislative changes under consideration to remove the statutory caps on director compensation and extend director terms from three to four years.

Conclusion

Over the years the FHLBank System has repeatedly demonstrated its ability as a member-driven cooperative to evolve to meet the changing needs of its membership and provide invaluable services to them and their local communities. I am confident that the FHLBanks will continue to meet these challenges.

The Council 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 any questions.

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[i] (GAO Report GAO-01-873, "Federal Home Loan Bank System: Establishment of a New Capital Structure", July 2001, p. 9)

[ii] (Diana Hancock, Andreas Lehnert, Wayne Passmore, Shayne M. Sherlund, *"An Analysis of the Potential Competitive Impacts of Basel II Capital Standards on U.S. Mortgage Rates and Mortgage Securitization"*, Federal Reserve Board, April 2005, p. 12)

[iii] *Washington e-Perspective*, America'a Community Bankers, March 9, 2005

[iv] *Twelfth Annual Survey of Community Bank Executives*, Grant Thornton, March 2005

[v] John A. Tucillo, Frederick E. Flick, Michelle R. Ranville, *"The Impact of Advances on Federal Home Loan Bank Portfolio Lending: A Statistical Analysis"*; JTA, LLC, February 2005

[vi] James B. Thompson, *"Commercial Bank's Borrowing from the Federal Home Loan Banks"*, Federal Reserve Bank of Cleveland, July 2002

[vii] Marsha J. Courchane, Darcy Steeg, *"A Comparative Analysis of FHLBank Member Mortgage Lending"*, Welch Consulting, February 25, 2005