STATEMENT OF

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TO THE
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

OF THE
UNITED STATES SENATE

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Good morning Chairman Shelby, Ranking Member Sarbanes, and Members of the committee. I am Norman B. Rice, President and Chief Executive Officer of the Federal Home Loan Bank of Seattle.

I'd like to thank Chairman Shelby and the committee for the opportunity to speak today on behalf of the Council of Federal Home Loan Banks, and the more than 8,000 member financial institutions that partner with us in building healthy communities and economies across our country.

I think it's appropriate for me to start this morning by commending Congress for two things regarding the Federal Home Loan Bank System:

The first is for creating the 12 banks under the authority of the Federal Home Loan Bank Act of 1932. Congress created the banks to both stabilize and improve the availability of funds to support homeownership in this country. And the banks have delivered an unmatched legacy of innovation and service to the U.S. housing market for the last 70 years.

The second is for the current work underway regarding regulatory restructuring of the housing GSEs. Clearly, Congress has the right and responsibility to scrutinize the regulatory oversight of the housing GSEs, and to ensure that they provide the nation's network of community-based financial institutions with the safest, soundest source of residential mortgage and community development credit possible.

Like the members of this committee, the 12 Federal Home Loan Banks seek world-class regulatory oversight of our system. After all, our members have almost $40 billion in private capital invested in our banks. Due to our joint and several liability, we seek the same quality oversight and transparency that are of paramount concern to you, the U.S. Treasury, bondholders, and the public.

Along with the regulatory reform process now underway, the Bank System is also working toward voluntary SEC registration, pending resolution of critical accounting and reporting accommodations.

On September 17, 2003, the Federal Housing Finance Board issued a proposed regulation that would require the 12 banks to register their stock with the SEC under Section 12(g) of the 1934 Securities and Exchange Commission Act. Under this regulation, the Home Loan Banks would also be required to submit periodic and current reports such as 10Ks, 10Qs and 8Ks.

Each bank has until January 15, 2004 to provide comments on the proposed regulation to the Finance Board.

The Seattle Bank Board of Directors, at our September 2003 meeting, adopted a resolution calling for voluntary SEC registration, and we are now moving to make that happen.

In addition, over the last year, the system's SEC Task Force has met several times with SEC officials to discuss the resolution of outstanding accounting and reporting issues we believe are necessary to accommodate the unique cooperative structure of the Bank System.

The bottom line: the goal of the Home Loan Banks is to provide complete and transparent financial disclosures that are considered no less than "best in class."

So I am pleased to sit before you today representing the collective intent of the Home Loan Banks to work diligently toward that goal as the process and debate around regulatory reform moves forward.

Among the 12 Federal Home Loan Banks you'll find at least three banks – Boston, Cincinnati, and Indianapolis – that do not support direct regulatory oversight by the U.S. Treasury. These banks strongly believe that because the Bank System and Treasury are competitors in the capital markets – and Treasury provides an emergency line of credit to the banks – a systemic conflict of interest would be created. Therefore, they support maintaining the current regulatory structure provided by the Federal Housing Finance Board, which was approved by Congress in 1989 when finalizing FIRREA legislation.

While there remain clear differences of opinion within the Bank System on the matter of regulatory reform, we have reached consensus on four principles that we believe must serve as a framework for specific action and represent our bottom-line concerns as Congress moves forward on legislation.

These principles are as follows:

Number 1 -- Preserve and reaffirm our mission.

Mission is everything. Otherwise, why should any of the housing GSEs exist? We strongly believe that any legislation should accomplish the following regarding the mission of the Bank System:

- Provide cost-effective funding to members for use in housing finance and community development.
- Preserve our regional affordable housing programs, which create housing opportunities for low and moderate income families. Since the inception of our Affordable Housing Programs in 1991, the Bank System has contributed more than $1.7 billion in grants to communities across America.
- Support housing finance through advances and mortgage programs.
- Allow for innovative new business activities that advance our mission without creating a cumbersome process that prevents us from responding in a timely way to the needs of our member financial institutions and the marketplace.

Number 2 -- A strong and independent regulator.

Safety and soundness of the Bank System is our No. 1 concern. This is neither a partisan nor an ideologically-driven endeavor. It is for this reason we ask that Congress protect the Bank System through the creation of a strong and independent regulator. This is absolutely consistent with the role of other bank regulatory agencies, in which the regulator responsible for safety and soundness has free and unfettered authority to determine policy, rulemaking, application, adjudicative and budget matters.

The primary responsibility of the regulator is to implement policy made by the Congress, and to do so in a safe and sound manner. We strongly believe that a regulator lacking true independence may eventually find itself pursuing other agendas, not the will of Congress, nor what is demanded to assure safety and soundness.

Number 3 -- Preserve Bank System funding.

The reason a GSE can advance its housing mission more effectively than fully private companies is simple – we have a cost of funds advantage due to our GSE status. It is critical that we ensure that nothing is done to any of the housing GSEs that increases their cost of funds and, correspondingly, increases costs for financial institutions and consumers.

In fact, we are convinced that strong, independent and skilled regulatory oversight will give greater confidence to investors and continue to help us advance our housing finance mission.

Therefore, any legislation must:
- Preserve the role and function of the Office of Finance.
- Ensure that neither the U.S. Treasury, nor the independent GSE regulatory unit, has the ability to impede or limit our access to the capital markets without cause.
- Not limit the financial management tools available to the GSEs to prudently manage the financial risks inherent in our funding and business activities.

Although the shared service of the Office of Finance should be owned and operated by the Home Loan Banks – and the banks should establish its governance principles and scope of operations – we believe the OF must be subject to the regulatory authority of any new regulator.

Number 4 -- Preserve the unique nature of the Bank System.

While all three GSEs have much in common, we believe it is important to both recognize and preserve the unique nature of the FHLBanks.

Therefore, any legislation must:

- Preserve the cooperative ownership of the Bank System and the joint and several liability that is the underpinning of the Bank System.
- Preserve the unique regional structure of the 12 banks that assures we are locally controlled and responsive to the financial and economic development needs of our local communities.

Regardless of the regulatory structure established by Congress, we believe these principles must be considered as you move forward in your policymaking.

In closing, I would like to put forward some thoughts that reflect my own thinking on these matters.

I believe there are two threshold issues that can help you attain your benchmark purpose of protecting the public interest in the housing GSEs.

First, there is much that separates the Home Loan Banks from the two other housing GSEs, and these differences must be fully recognized and factored into any regulatory reform measures being considered.

Let me list what I consider to be the key differences:

- Our mission is somewhat broader than the other housing GSEs, incorporating economic and community development.
- There are different capital requirements, with the FHLBanks required to hold 4 percent capital and the others required to hold a lower percentage.

  When new capital rules were established by Congress through Gramm-Leach-Bliley, there was wide agreement among economists that the Home Loan Banks were required to hold too much capital against advances.

  Given that the Bank System has NEVER suffered a credit loss on advances, a 4 percent minimum requirement, we believe, is excessive. It is important to keep in mind that requiring too much capital can sometimes work against the goal of safety and soundness. If an enterprise is underleveraged, it can create pressure to take greater risk in order to generate better return on equity.

  In the secondary mortgage business, the likelihood of credit losses within the Bank System has increased. However, Fannie Mae and Freddie Mac, who get paid a fee to put credit risk on their books, are required to hold less capital, while the Home Loan Banks – who compensate lenders for keeping the credit risk on their own books – are required to hold nearly twice as much capital. We believe capital requirements should be standardized for all three housing GSEs.

- The Bank System is cooperatively owned and capitalized by our members, while the other housing GSEs must meet the earnings and stock valuation expectations of Wall Street investors.
- Two housing GSEs pay federal income taxes, but the Home Loan Banks pay special taxes equivalent to the federal corporate income tax rate of 26 percent. We are required to contribute 10 percent of our net income for affordable housing grants while the other GSEs have affordable housing goals.

This is a highly efficient way of passing on our GSE subsidy, to directly impact affordable housing and economic development in the communities we serve. Though we appreciate the goals the other housing GSEs maintain, we believe – as do most – the best way of passing along our GSE subsidy is through our Affordable Housing Program and the direct 10 percent contribution made by each of the 12 Home Loan Banks annually.

The Bank System, in 2002, generated $199 million to award as AHP grants and subsidies, and over the last 13 years has awarded more than $1.7 billion in grants and subsidies, making the banks one of the largest sources of private funding for affordable housing in the nation.

The Affordable Housing Program targets incomes lower than those established by the housing goals administered by HUD. Affordable Housing Program subsidies must be used to fund the purchase, construction or rehabilitation of:

- Owner-occupied housing for very-low income, or low- or moderate-income (no greater than 80 percent of area median income) households; or
- Rental housing in which at least 20 percent of the units will be occupied by and affordable for very low-income (no greater than 50 percent of area median income) households.

AHP subsidies may be in the form of a grant (direct subsidy) or a below-cost interest rate on an advance from a Home Loan Bank member institution. In supporting home purchases, AHP funds may also be used for down-payment assistance for income-eligible, first-time homebuyers.

These are not inconsequential differences.

But, in fact, we increasingly have more in common. Most importantly for purposes of this discussion, we are all managing increasingly complex sets of financial, operating and accounting risks. For example, all three housing GSEs pursue very sophisticated interest rate risk management strategies. And, all three would benefit from more rigorous oversight of these activities.

In my view, as business activities and associated risks converge among the GSEs, so, too, must the regulatory oversight evolve and adapt to a more complex world, and to greater scrutiny by Congress, the marketplace and the American people.

Secondly, the choices you make on regulatory reform must be based on an underlying philosophy about the housing GSEs. In your judgment, is the public interest best advanced by encouraging competition among the housing GSEs or encouraging market domination by them?

It should come as no surprise that I have some views on this topic.

At the urging of the bank members of our system – the nation's home lenders who own our cooperative – we have chosen to compete. That's why we jumped with both feet into the mortgage purchase business. In the end, the nation's home lenders will better serve the nation's homebuyers if there are choices and competition in the secondary mortgage market.

We welcome that competition because we are convinced we have a better way to meet our Congressionally-mandated housing mission – to create homeownership opportunities. Because we are a cooperative, we are not beholden to the kinds of expectations of Wall Street investors, and because of the way we purchase mortgages, more of the risk is dispersed to those best able to manage the risk.

From a public policy point of view, full-fledged competition among GSEs is a way to more prudently manage GSE growth and to disperse risk among more investors.

The decisions you are about to make on regulatory reform and oversight will directly influence how this country best serves our network of community banks and consumers, and how we best protect the public interest and investment in the housing GSEs.

It is my job, as a President and CEO of one of the 12 Home Loan Banks, to preserve and enhance the strength, integrity and value of our Bank System, and continue its legacy of service to our member financial institutions and the communities they serve.

Every day, I remind myself that I work for a cooperative that has, at its core, a public mission of making our communities better places to live and work. I don’t own any part of this bank; it is owned by our members, and we are, at all times, fully accountable to them.

My role is to protect and enhance this cooperative, for the good of our financial institutions, our communities and the overall public interest invested in the Home Loan Banks -- the same purpose that each of you bring to this process.

I look forward to continuing to work closely with members of Congress and the U.S. Treasury as we look for new and better ways of strengthening the oversight and value of our housing GSEs.

Thank you for your time this morning. I would be happy to answer any questions you may have regarding my testimony.