

**TESTIMONY OF**  
**NORMAN B. RICE**  
**PRESIDENT AND CHIEF EXECUTIVE OFFICER**  
**FEDERAL HOME LOAN BANK OF SEATTLE**

**BEFORE THE**  
**SUBCOMMITTEE ON FINANCIAL INSTITUTIONS**  
**OF THE**  
**UNITED STATES SENATE**

**SEPTEMBER 9, 2003**

Good afternoon Chairman, Ranking Member Johnson, and Members of the subcommittee. I am Norman B. Rice, President and Chief Executive Officer of the Federal Home Loan Bank of Seattle.

I'd like to thank Chairman Bennett and the subcommittee for the opportunity to provide my perspective on the unique and vital role the Federal Home Loan Banks play in building strong communities and healthy economies across America.

The 12 Federal Home Loan Banks have a long history of service and accountability to the more than 8,000 financial institutions we serve, to the millions of individuals and families we help realize the American dream of homeownership, and to the regulators and Congress who oversee our system.

But it isn't the history of our banks that I want to talk with you about this afternoon. Where we've been and what we've accomplished as a Bank System is significant and well documented. But my focus is on the relevance of the Bank System today -- and in the future -- and the critically important role we play on behalf of our financial institution members, and the economic health of our country.

I'll start with what I consider to be the most important element of the Federal Home Loan Banks -- we're a cooperative. Our members own the Bank System, and we are accountable to them.

We are truly unique in that sense. By constructing the Home Loan Banks as a cooperative, Congress ensured that all value and benefits from the system are passed directly back to the member financial institutions that are the lifeblood of small business, agriculture and neighborhood revitalization in this country.

These are the banks, credit unions, thrifts and other institutions that give communities critically-needed access to credit; these are the risk-takers whose leadership and resources build stronger towns, cities and, to a very real extent, a stronger nation.

You can do that in a cooperative that provides each one of its members – small and large -- the same access to a stable, low-cost and reliable source of wholesale funding. In turn, you can't do what we do in a publicly traded company where your primary focus is building investor value for tens of thousands of individual stockholders.

It works much differently in the Federal Home Loan Bank System. We have a business relationship with each of our members – they are both our owners and our customers. We know them by name. We understand their individual market needs and the needs of their communities. They are represented on our boards and provide the leadership of our 12 banks.

No other housing GSE or financial institution can replicate this partnership of bank, member and community.

At the Seattle Bank, we like to use the term “rock solid” to characterize our organization and the business relationship we have with our members. It conveys a sense of accountability and commitment to our cooperative, and the unwavering belief that a member's investment is being managed for the long term, not just quarter to quarter. That's how our member financial institutions see us – as a safe, sound partner they can use to more effectively manage their balance sheets – in good economic times and bad -- for the purpose of better serving their local customers and communities.

Within the cooperative structure of the Bank System, it's also important to understand the profile of our membership. The overwhelming majority of our member financial institutions are smaller, community-based companies. Our typical member has about \$110 million in assets, almost half of our members are located in rural areas, and most are independently owned.

We also serve the nation's largest lenders. Our congressionally mandated mission is to make bank credit available for our local communities. Given the realities of the financial services industry, which has consolidated enormously, it would simply be impossible to fulfill our mission unless we also supported the largest lenders who now account for a vast amount of lending activity. For example, the top three U.S. lenders now account for 37 percent of all home mortgage originations. The top 30 originators account for 60 percent of all loan originations.

As you can see, the Bank System cooperative is a place where financial institutions of all sizes share mutual interests and share mutually in the benefits of their joint enterprise.

As I sit before you today, the Federal Home Loan Banks and the housing GSEs are facing significant challenges and changes regarding their business practices, regulatory structure and mission-based programs and activities.

There is much to discuss and determine in the coming months, and potentially much at stake for financial institutions, businesses, homebuyers and the American economy.

As this sub-committee and other members of Congress consider the future of the Federal Home Loan Banks and the housing GSEs, you will no doubt be inundated with recommendations and solutions from many people representing many of the constituencies that have come before you today.

As a former public policymaker, I remember that process all too well. But in place of recommendations and solutions, I would like to offer you two things today: some baseline questions and principles to consider in your discussions in the weeks and months ahead, and clear evidence of the powerful impact the Bank System has on our country's financial services industry, our communities, and our economy.

First, two questions that I believe appropriately frame the issues now before Congress regarding our Bank System and housing GSEs.

- What are the benefits and risks that the housing GSEs present to taxpayers?
- How are the risks best managed?

Over the course of any week in my job I'm asked by a number of people what the Federal Home Loan Bank of Seattle is, and what it does. For those not involved in the banking and financial services industry, our system is, for the most part, unknown. So I'm always pleased to provide some quick education, and pleased because of the answer I'm able to give: We help ensure that Americans have homes and healthy local economies.

How do we do that? By connecting financial institutions of all sizes to the capital markets. This provides our member banks with a stable source of lower-cost funds that they use in their own communities to support homebuyers, businesses and farmers.

But perhaps an even better way to illustrate the benefits of the Bank System is to imagine our country without the 12 Home Loan Banks. Consider the following:

- In 2002, the Bank System extended nearly a half trillion dollars in advances (what we call loans) to our member financial institutions, strengthening local economies and increasing homeownership.

**Imagine those dollars gone.**

- Since 1991, the Federal Home Loan Banks have awarded \$1.6 billion in Affordable Housing Program grants, helping to create 360,000 low-income housing units across the country. Each of our 12 banks annually provides 10 percent of their net income for affordable housing. Last year, that totaled about \$200 million.

**Imagine those dollars gone.**

- In 2002, the Bank System provided nearly \$9 billion in reduced-rate, long-term Community Investment Program (CIP) advances, used by our member financial institutions to finance commercial and economic development initiatives that benefit low- to moderate-income families and neighborhoods. Since CIP began in 1990, our banks have issued nearly \$36 billion in reduced-rate loans.

**Imagine those dollars gone.**

Now imagine the collective impact on our national economy, not to mention individual business owners, homebuyers, and farmers.

Ask yourselves who would provide the bank credit to support your local economies? How would your local bank compete if they didn't have access, through their regional Home Loan Bank, to the capital markets? Where would these institutions turn, in good times and bad, to meet loan demand despite the outflow of consumer deposits from the banking system? Where would your constituents go to get loans to buy homes and run their businesses?

Now go one step further: If the housing GSEs did not exist today, what would Congress put in their place? I believe you would come back to something that looked a lot like the Federal Home Loan Bank System.

Here's why:

- **The Bank System is funded entirely through private capital.** The cooperative is built by private owners who have put more than \$36 billion of their own money at risk to capitalize the Bank System.
- **The Bank System is cooperatively owned to support – rather than compete with – the private marketplace.** Our stock is not publicly traded. We are not driven by an imperative for double-digit growth to meet expectations of the stock market. We don't have third-party investors pulling value out. Every dollar of value created by the Bank System is poured back into the housing finance system, ultimately

- benefiting your constituents, the consumers of bank credit. Those are bank owners, business owners, farmers, homebuyers, non-profit housing corporations, neighborhood social service organizations, municipalities and many, many others.
- **The Bank System has the capacity to innovate and keep pace with an evolving financial services industry.** This is why the Bank System offers mortgage purchase programs. Our members have told us they can better serve homebuyers and local markets if there is more competition in the secondary mortgage markets. It is no accident that our system's program volume has accelerated from zero to almost \$100 billion. Without question, there is a private-market demand for competition, and we believe that competition is healthy – it's good public policy. And it's equally important to remember that when programs such as these boost earnings and profitability in our banks, that provides more funding for affordable housing and economic development in our communities. At the Seattle Bank last year alone, our Mortgage Purchase Program generated \$1.75 million in additional AHP subsidies. My point here is, you cannot disconnect profitability and mission with the Bank System.
  - **The Bank System is organized by region, ensuring that each bank is connected and responsive to local markets.** Twelve Home Loan Banks were created to focus on local markets, to know their local member financial institutions and create products and services that meet their customers' needs and the affordable housing and economic development needs of their communities.
  - **The Bank System pays its fair share of taxes.** The Home Loan Banks carry a special tax burden that cannot be sheltered and is equivalent to a federal corporate tax rate. The Bank System has been required, since 1989, to pay off the Refcorp debt and provide 10 percent of its net income in support of low-income housing. This is the single-largest private source of housing subsidy in the U.S.
  - **The Bank System is a reliable source of liquidity through all parts of the economic cycle.** This is the primary reason why financial institutions join the Bank System. They rely on our capacity to access the capital markets on their behalf. That's why, even in a down economy, demand for advances across all of our banks has reached nearly a half trillion dollars.

As you can see, it's not a difficult task for me to list the benefits provided by the Bank System. Over the last 70 years, the 12 Home Loan Banks have consistently proven their relevance to our members and their communities.

The harder question – especially in today's environment – is whether or not the risks are being managed appropriately. While it's one thing to say our advance and mortgage purchase programs drive profitability and support mission-based programs and activities – which they do -- it's quite another to ensure that the risks inherent in those programs are being managed appropriately.

My colleagues testifying on this panel today will address other key issues regarding the Bank System, including risks associated with financial management, governance and regulatory oversight.

Just as I have noted some attributes and principles that should underlie a modern housing GSE, I would like to also articulate some basic principles as you consider GSE oversight going forward.

First of all, it would be disingenuous of me or anyone else to state that the Home Loans Banks and other housing GSEs are far bigger and more complex, and therefore should be held to different risk standards. Clearly, the bar has been raised across the financial services industry in this regard.

While history proves that we have done a great job for a long time – not a single credit loss against advances since the inception of the bank system in 1932 -- I also understand this is 2003, not 1932, and much more must be done. Your constituents and ours are demanding the highest levels of accountability, and we must deliver on that.

On the matter of consolidation of the GSE regulators: Whether or not Congress determines that a single GSE regulator is the appropriate direction or not, all three housing

GSEs must have strong regulatory oversight to ensure both safety and soundness and mission achievement. There can be no debate on that point.

The fact is that the three housing GSEs must manage many of the same risks, and we share a common mission – to support homeownership by providing the funding and the tools the nation’s housing lenders need to be successful. That means it is time to straighten out the hodgepodge of inconsistent requirements and oversight of the housing GSEs.

For example, why do two housing GSEs have lower capital requirements than the Home Loan Banks that demonstrably carry less credit risk? Why is there inconsistent mission oversight – with the Home Loan Banks delivering cash grants, while the other housing GSEs hit a different set of affordable housing goals?

What public policy goal is advanced when roadblocks are put in front of our Bank System when we respond to our members’ stated desire to have greater competition in the secondary mortgage market? And when, in fact, those roadblocks actually hinder our ability to drive more funding to our member financial institutions and their communities? I’ve heard it called “mission creep.” From my point of view, it’s more like “mission leap” – it allows us to take more significant steps toward fulfilling our mission, not walking away from it.

While it is often frustrating to me that the Bank System’s mission and impact is understood by so few, I think it’s apparent that this nation and your constituencies -- our financial institutions and local communities -- would struggle mightily if we failed to do our job.

Today, as one of 12 presidents within the Federal Home Loan Bank System, I stand committed to work with you to find better ways to serve the ever-changing needs of the financial services industry and our communities.

I want to be clear that I believe the onus for strengthening our system lies not only with Congress and regulators, but with the Home Loan Banks themselves. We must further



step up and accept the risks in our system and industry, and accept that more intense public oversight is inevitable. We welcome that public oversight because, if done smartly, it will strengthen our Bank System and, ultimately, the economy of this country.

In closing, I would like to leave you with some principles that I believe should inform your discussions and decisions in the months to come:

1. Private capital is the most effective cushion to guard the public against the risks inherent in our enterprises. As cooperatives, the Home Loan Banks are capitalized by their customers, who are risk-averse, and who monitor risk-taking in a way that third-party shareholders cannot.
2. Insist on competition among housing GSEs rather than competition with the private financial services industry.
3. Demand that more of the value created by the housing GSEs be delivered to the housing finance system and consumers rather than private investors.
4. Demand consistent, strong and smart regulatory oversight for all housing GSEs – and recognize the critical differences between the Bank System and publicly traded housing GSEs.
5. Demand an intense focus on our mission, hold us accountable, and keep in mind what America would look like if the Home Loan Banks did not exist.

Mr. Chairman, this concludes my written remarks. Thank you, again, for allowing me the opportunity to speak with you today. I would be happy to answer any questions you or other members of the subcommittee may have.