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HUD'S REPORT TO CONGRESS ON THE FEDERAL HOME LOAN SYSTEM

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BEFORE THE

SUBCOMMITTEE ON
GENERAL OVERSIGHT, INVESTIGATIONS,
AND THE RESOLUTION OF
FAILED FINANCIAL INSTITUTIONS

OF THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS
HOUSE OF REPRESENTATIVES

ONE HUNDRED THIRD CONGRESS

SECOND SESSION

MAY 24, 1994

Printed for the use of the Committee on Banking, Finance and Urban Affairs

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HUD'S REPORT TO CONGRESS ON THE FEDERAL HOME LOAN SYSTEM

TUESDAY, MAY 24, 1994

HOUSE OF REPRESENTATIVES, SUBCOMMITTEE ON GENERAL OVERSIGHT, INVESTIGATIONS, AND THE RESOLUTION OF FAILED FINANCIAL INSTITUTIONS, COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS,
Washington, DC.

The subcommittee met, pursuant to notice, at 10:04 a.m., in room 2222, Rayburn House Office Building, Hon. Floyd H. Flake [chairman of the subcommittee] presiding.

Present: Chairman Flake, Representatives Hinchey and Roth.

Also present: Representative Baker.

Chairman FLAKE. Good morning. We would like to welcome members and witnesses who came for this hearing before the Subcommittee on General Oversight, Investigations, and the Resolution of Failed Financial Institutions.

I am certain each of you is aware of my strong interest in rebuilding America's distressed and rural communities. Toward that end, today's hearing will focus on issues that I believe are critical to the economic stabilization of these financially underserved institutions and communities.

Following the publication of the final report in a series mandated by the Housing and Community Development Act of 1992, I believe today's hearing is a necessary continuation of a dialog that this subcommittee began last year in a review of the role of existing financial intermediaries in support of community and economic development. These analyses by HUD, the Federal Housing Finance Board, the GAO, the CBO, and the members of the Federal Home Loan Bank System advanced several possibilities for reform of the Federal Home Loan Bank System.

It has always been my sincere belief that our Nation's existing financial infrastructure has the capacity to revitalize all of America's distressed communities. What is needed now is a willingness to recognize this vast potential market and incentives to encourage all financial service entities to participate in this rebuilding process. Indeed, I often suggest that one of the most fertile fields of opportunity that has often been ignored by our financial entities has been these communities that are underserved.

With that in mind, the administrative reform of the Community Reinvestment Act and the Community Development Financial Institutions legislation are merely the beginning of an economic renaissance in this country. By no means should these efforts be viewed as the only methods for achieving permanent revitalization of distressed communities.

HUD, for example, has some exciting ideas for community renewal in its legislative reauthorization proposal which I look forward to examining further when it is marked up by the Banking Committee. Along those same lines, the GSEs have enormous potential, consistent with their public policy purposes, to make a difference in how credit is provided to all American citizens.

In that regard, this subcommittee received testimony last April from Mr. DelliBovi and Mr. Schultz on the Federal Home Loan Bank Board System's success with the Affordable Housing Program, which is the acronym AHP, and the Community Investment Program [CIP]. The AHP's subsidies total $233.9 million and have leveraged $3.3 billion in community development. Moreover, through the CIP, the Federal Home Loan Bank System has disbursed $4.5 billion in advances at its cost of funds to be used by members for low- and moderate-income housing loans and economic development in distressed areas.

I believe that there is enormous potential for community and economic development in activities of the Federal Home Loan Bank System through its many members. The Federal Home Loan Bank System has a unique position in that it is able to advance funds to community portfolio lenders which provide nonconforming loans to finance affordable housing and community development initiatives.

The mortgage finance system has indeed changed dramatically in the last 20 years, and I look forward to assisting you in reshaping your role in this system, one which complements the activities of the secondary mortgage market, Federal National Mortgage Association, and the Federal Home Loan Mortgage Corporation.

Last month, we heard from Fannie Mae and Freddie Mac on their compliance with HUD's affordable housing goals and determined that more needs to be done to provide all Americans with equal access to all credit and financial opportunities. The Federal Home Loan Bank System occupies a unique position in this mosaic, and I look forward to working closely with this administration in the next year to develop a legislative initiative that will reform and enhance the Federal Home Loan Bank System and protect the essential programs and opportunities it provides for America's community developers.

Today, I look forward to each witness' thoughts on the 14 questions posed by the Congress, especially the statutory mission and its achievement of public policy goals.

Because of the number of witnesses, we will have three panels this morning. We will introduce them after we hear the opening statement by the ranking minority Member of this subcommittee, Mr. Toby Roth of Wisconsin.

Mr. ROTH. Thank you, Mr. Chairman.

It is a pleasure for us to be here today. The long-awaited HUD Report on the system is now complete and before us. The recommended reforms are ready for congressional consideration. I think, Mr. Chairman, you touched on that in your statement.

Our subcommittee hearing today is the first on the HUD Report. I look forward to receiving this testimony about these reforms.

Not so long ago, the notion was widespread the system had outlived its usefulness. In 1992, Congress directed studies from the GAO, Congressional Budget Office, and the Federal Housing Finance Record. All studies are now complete. The consensus is that the Federal Home Loan Bank Board System does have an important role to play.

The System itself has changed enormously. Commercial bank members outnumber savings and loan members by 1,536 to 1,759. Advances to members have turned upward to $103 billion in 1993, up from $76 billion in 1992.

I think the question we are asking ourselves is, where do we go from here? The HUD Report says a new mission statement is needed. What capital structure should the System have? Should membership be voluntary? What should be done about the annual $300 million RefCorp payment on the S&L bailout? How can we strengthen the Affordable Housing Program, which we are told has flourished without much heavy-handed regulation? This morning's testimony is a start toward building a record of legislative action.

Mr. Chairman, other members have been calling and have asked that they would like to submit additional questions for answering in the record. If that is permissible with you, I would like to ask you to comply with their wishes and allow them to do that.

Chairman FLAKE. By unanimous consent we will do so, Mr. Roth.

Mr. ROTH. Thank you, Mr. Chairman.

Chairman FLAKE. Our first panel consists of two persons with whom I have had numerous conversations in relation to community development. Mr. Nicolas Retsinas, who was with us last month and has been working diligently at HUD to propose legislation that I think will be helpful to all of us as we begin the process of rebuilding this third world nation within our borders. I would like to put that out and not let it drop.

Mr. Larry Costiglio, who has had firsthand observation of what we tried to do in New York, what I tried to do as a community developer and advocate. I certainly am happy to welcome you as a member of the Finance Board this morning to come and testify before this subcommittee.

You have the option of summarizing your statements and then being prepared to respond to questions that we might pose to you.

I know that Mr. Baker will be here soon and has some questions that he would like to ask. If he is not here, we will have unanimous consent that he will submit those questions to you.

We will start with you, Mr. Retsinas. Happy to welcome you again.

STATEMENT OF NICOLAS RETSINAS, FEDERAL HOUSING COMMISSIONER, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Mr. RETSINAS. It is indeed a pleasure to be here before this subcommittee once again.

As you recall, Mr. Chairman, it was but a month ago that I testified before this subcommittee on assessing the initial year of performance of the GSE, in particular Fannie Mae and Freddie Mac as relates to affordable housing goals. I found that testimony very useful in summarizing information, and I think it will contribute to ongoing deliberations about their role.

It is appropriate today that we focus attention on the Federal Home Loan Bank System as a different kind of GSE but one we believe has enormous potential to further the cause of developmental lending which you so persuasively, in my mind, argued for.

I also want to thank you, if I may, Mr. Chairman, for the kind reference to our own Department's Reauthorization bill. That includes many initiatives we think will be supportive of trying to undertake a broader sense of empowering our communities to ensure they are on the road to recovery.

I also want, if I may, to make note of my colleague here this morning, Larry Costiglio. Larry is a Director of the Federal Housing Finance Board, has been a long-term Director of the Board and is an important—provides an important source of history and future in terms of where the Board is going.

Being cognizant of the time constraints of this panel and understanding the impressive list of witnesses that you have on the next two panels—some of our best bank presidents from around the country as well as very appropriate representatives of shareholders in the system—I would like to take advantage of your offer and just orally summarize the longer written statement that I would like to submit for the record. In so doing, I would maximize the time we have for questions that you may have or other members of the subcommittee may have.

As Congressman Roth indicated, HUD within the last 3 weeks has completed the last of five mandated studies of the Federal Home Loan Bank System. Let me say at the outset how pleased I am that this subcommittee has so expeditiously gone from the publication of that report to the conducting of this hearing. This is the appropriate next step in the process.

The study was just that, a study. It is not the end of a process. It is the next step in the process, a process that will eventually culminate in legislation for this subcommittee and your colleagues to consider in the days and weeks ahead.

What I would like to do this morning is summarize the central conclusions of the HUD Report, not walk through each of the 14 questions—our written testimony does that—but really focus on issues we think undergird consideration of where we are going, the Federal Home Loan Bank System.

As we all know, as our study reviews—as the other studies review, the Federal Home Loan Bank System itself was created back in 1932. It was created as one of a number of institutions created by the Federal Government to try to deal with the economic recovery, to try to get this country out of a depression.

The world in 1932, to say the obvious, was very different than the world in 1994. There is a very different system of housing finance. There is a very different system of capital markets, the emergence of secondary markets. The way they function today was unheard of and unthought of back then.

The first question addressed by the HUD study was the question posed in your opening statement. Is there still a need for the Federal Home Loan Bank System? Does it still make sense? Is it still worthwhile?

Not only from our study but from my active participation on the Finance Board and System over the last year, I would answer that question very positively and conclusively. Yes, there continues to be a role for the Federal Home Loan Bank System. We think the strength of the System, the strength of this GSE—all GSEs have other strengths, but the strength of this one is its delivery system, those members, those 4,600 plus members that now make up the Federal Home Loan Bank System.

The first issue I would like to speak to this morning is the mission of the System. We believe that it is appropriate to, one, reaffirm the basic, primary mission of the Federal Home Loan Bank System, which is to promote housing finance in this country. Home ownership, safe, and decent affordable housing, remains an aggressive and ambitious goal for this country. We believe the Federal Home Loan Bank System ought to reaffirm its role in promoting home ownership and decent housing for all Americans.

Further, however, we believe this system has the potential to expand its mission. We believe, therefore, not only do we need to reaffirm and codify through statute that public purpose mission, that housing finance mission, but that we believe the system has the potential to engage in what we call safe and sound community development lending.

It seems to me that the system has the potential to be community development lenders, to seed, spawn a whole plethora of community development lenders throughout the country.

We were careful in the study not to prescribe the particular form of that lending. It would be heavy-handed for us to do so. But we believe we can create an environment, we can send the signals, because we believe these institutions, these members, are so grounded in their community that they are best positioned to undertake community development lending.

So, therefore, our first conclusion is just that: A reaffirmation of the housing finance mission of the System, an expansion of that mission to cover community development lending.

We are careful in the report not to suggest we do that through an elaborate regulatory process. We suggest that our primary way of ensuring adherence to that mission is through what we believe is a rigorous consideration and we believe improvements and modifications to the CRA rules. We believe that those rules have the potential to further encourage our members to take active roles in housing, finance, and community development lending, though we do suggest in the study some fall-back positions if that does not appear to do the job in terms of following through on the mission.

The second major issue I would like to comment on is capital structure. Let me start with the premise, if I could, Mr. Chairman, members of the subcommittee, which is that I believe that this, in fact, is a GSE, which means to say it is a system that is entirely dependent on its ability to attract and retain capital. In fact, the achievement of its public purpose mission must always be balanced to find out to what extent that mission obviates the ability to attract and retain capital.

Therefore, we join—the HUD study joins the chorus of other studies previously completed to talk about the need to solidify a permanent capital base for the System. While we suggest in the study a number of options, including retained earnings, the injection of tradeable stock, other kinds of investment capital, we believe this is a work in progress, and we believe this hearing is a beginning of a time to further explore what those options are.

This is a very fragile situation. It is a situation that really calls for understanding how the system is structured. Therefore, we need to make sure we proceed prudently.

Our goal over the course of the next several months is to continue to reach out using these hearings, using other forms of consultation, and to pull together a legislative proposal that will, of course, be more specific on what that capital structure ought to be. But we think that that deliberation ought to be a consultative process because, again, it goes back to my original premise. The premise is the System must retain and attract private capital. So, therefore, we need to talk with the potential investors of that capital of how best to structure that System.

Point number two——

Chairman FLAKE. Regarding that point, may I assume that you have not set a timetable but you are working the process in front of setting the timetable so that, by the time you move to the point of trying to put a timeframe on it, you have worked out most of the details?

Mr. RETSINAS. I believe, Mr. Chairman, the process ought to be consultative. This is a process that needs maximum involvement. This is not a process that ought to take place behind closed doors. It needs consultation with Members of Congress because of your deep concern on these issues. It needs consultation with the parties affected, the shareholders, regional banks, a whole series of processes.

I wish I could say to you all that process took place, and now we have the answer. What I found in my examination of the System is that it has a Rubik's cube quality. The moment you think you solved one issue, it affects another issue.

Chairman FLAKE. I never solved the Rubik's cube.

Mr. RETSINAS. Somebody did. We are going to give it a shot, Mr. Chairman.

Chairman FLAKE. OK.

Mr. RETSINAS. There is an answer. We will try to figure it out together.

I don't want to sit here—one of the last things I learned—I have now celebrated, quote, unquote, my first year in Washington. I learned sometimes you can come to answers too quickly. Sometimes you need to come to answers prudently because it is more important to have the right answer than the quickest answer.

I think that is what we are engaged in, trying to find the right answer.

The third issue I would like to bring to your attention is the subject of membership. Again, if you believe in our premise that the System will depend on its ability to attract and retain capital, it seems to us you are inevitably drawn to the conclusion there ought to be, over time, a system of complete voluntary membership.

We are already moving to that now. As you point out, two-thirds of the members are current—are currently voluntary members. That is the future.

We need to make sure, however, that in so doing that we do not undermine the commitment of the System to two important obligations: One, the RefCorp obligation, which I will speak to in a moment; second, the commitment to the Affordable Housing Program. As Congressman Roth points out, that program works. We need to be careful we do not undermine the commitment to that program.

While we endorse the concept of voluntary membership, we need to ensure we have a way to get there without undermining the System and the goals of the System.

In terms of the RefCorp payment, this is a subject in all candor, Mr. Chairman, Congressman Roth, that we wrestle with, but it is our conclusion that it is a bona fide obligation. It is an obligation that needs to be met particularly in the budget environment we are in now. We continue to explore alternative ways of meeting that obligation, and while we do that, for purposes of this study at this point in time, we are not sure we found a better way, in all candor.

While we have some concerns about the current allocation system, what is important to note is that that remains an obligation. We need to find a way to balance that obligation with the appropriate kind of incentives to encourage the kind of safe and sound behavior the System has.

The last issue before I wrap up is the issue of governance and regulation. As I said before, the System has changed dramatically, not only over the last 62 years of its existence but, more specifically, over the last 5 years with the passage of the FIRREA legislation.

Our study comes to the conclusion that if the System is to realize its potential, that that potential is inhibited by the continued marriage of governance and regulation; that I am a believer, generally speaking, in decentralization. Having come from outside Washington to Washington, I understand the perils of centralization. While one needs leadership, you want to be sure leadership doesn't convert into micromanagement. At the same time, there is an appropriate regulatory or fiduciary responsibility.

I believe, therefore, and the study so states, that there ought to be a separation of the governance and regulatory responsibilities.

What we propose for your consideration or for a discussion is a separation into three parts: We believe that consideration ought to be given to transferring the safety and soundness regulatory responsibility to the new independent Office of Federal Housing Enterprise Oversight.

As you know, this was an office created by the Congress to oversee the GSEs. We understand that this office is in its first year. Therefore, we, of course, accept the notion that that is an issue that ought to be explored thoroughly. But we believe the theory of a centralized GSE safety and soundness regulator makes a lot of sense.

On the issue of its housing mission, we suggest that the subcommittee consider following the model created by the GSE legislation in 1992 which is a delegation of the housing mission to the Secretary of the Department of Housing and Urban Development.

We believe housing finance is a large issue that has a number of components. The secondary market is a component. My own FHA is a component. The Federal Home Loan Bank System is a component. We think that policy guidance ought to be exercised by the Secretary who is the responsible party within the administration to oversee housing policy.

As you know, Mr. Chairman, Congressman Roth has a strong belief—a strong passionate belief in housing, finance, and community development lending.

With the delegation of the safety and soundness regulatory responsibility to the Office of Federal Housing Enterprise Oversight, with the delegation of the housing mission regulatory responsibility to the Secretary of HUD, we believe that the governance, that is, the oversight of the business operations, be continued to be decentralized to the participating banks and through the banks to the members.

We believe that over time, certainly over the near term, there continues to be a need for a Federal presence in that oversight responsibility.

But, as an aside, Mr. Chairman, in my current capacity with the Finance Board, I have already begun an exercise in determining which operations can today best be delegated, best be sent out of Washington and into the local banks.

Again, oversight is important, but the day-to-day management is not something I am sure is best done out of Washington, DC.

In sum, Mr. Chairman, Congressman Roth, we do reaffirm the Federal Home Loan Bank System has an important role to play in housing finance in this country. We believe that role ought to continue to be focused on portfolio lenders. Because I certainly understand that, despite the emergence and growth of the secondary market, there are certain kinds of lending that do not lend themselves to the standardization, to the volume that is a necessary prerequisite of the participation in the secondary market. In particular areas such as multifamily lending, small business lending, have not seemed to lend themselves to a secondary market. We believe portfolio lenders could fill that niche.

This is not a system—in sum, Mr. Chairman, Congressman Roth, this is not a system that is broken today. We believe today the System is safe and sound. What we need to do is take steps to ensure it remains safe and sound and that it expands to fill not only yesterday's mission but today and tomorrow's mission.

With that, Mr. Chairman, Congressman Roth, I will be happy to answer any questions you may have.

[The prepared statement of Mr. Retsinas can be found in the appendix.]

Chairman FLAKE. Thank you very much, Mr. Retsinas, for very good testimony. I will have questions in a few moments.

Let me introduce Mr. Costiglio. Are you going to speak as well?

Mr. COSTIGLIO. Yes, I am.

Chairman FLAKE. It is a pleasure to do so, given that those of us who are advocates and developers in nonprofit communities in New York have had such great opportunities to work with Mr. Costiglio in programs, particularly some of the mortgage programs that allowed us to produce a myriad of affordable housing. I think we have a good model there. Hopefully, we can use some of the components of that as we develop more national programs for community development.

We are pleased to hear from you at this time.

STATEMENT OF LAWRENCE COSTIGLIO, DIRECTOR, HOUSING FINANCE BOARD

Mr. COSTIGLIO. Thank you very much, Mr. Chairman, Congressman Roth.

As you know from our previous meetings, Mr. Chairman, I was brought up in your district. I lived there for about 19 years.

Chairman FLAKE. Do you still vote there, though? That is the important thing.

Mr. COSTIGLIO. Good question. I moved a little bit north of there.

I also have spent some 30 odd years being involved in banking, housing, and community development finance in New York. As the Director of the Federal Housing Finance Board, I am pleased that you are holding these hearings and considerable effort has gone into the five studies submitted to Congress on the Bank System.

Through this hearing, I think you will find out that considerable consensus exists on what should be done to modernize the Federal Home Loan Bank System. I applaud nearly all of the recommendations in the HUD Report and am gratified to say the HUD Report comports with and builds on the report submitted by the Finance Board over a year ago.

In particular, I think you will be interested in the report's strong emphasis on the expansion of community development contained in the Finance Board and HUD Reports.

For nearly 10 months now, I have had the pleasure of working with Assistant Secretary Retsinas on the Finance Board. With the completion of this HUD Report, the final report, you have my personal commitment that I will work with him and with you and the members of the Banking Committee to develop viable legislation that preserves the positive attributes of the Bank System while taking important steps to ensure that its full public potential is realized.

Again, thank you very much, Congressman Flake, Congressman Roth, Congressman Baker. Thank you.

[The prepared statement of Mr. Costiglio can be found in the appendix.]

Chairman FLAKE. OK. Let me begin by just asking one question, Mr. Retsinas.

When you talk about the separation into basically three categories: Transfer of the oversight with regard to safety and soundness to the Federal Enterprise Oversight Board; delegation of the housing mission to the Secretary of HUD; and governance in oversight functions being retained by the banking Finance Board—is that correct?

Mr. RETSINAS. Yes. Included in the latter point is a continued decentralization of business operations to the member banks, a subset of that.

Chairman FLAKE. One of the questions I am sure we would have concern about—obviously, we have a great deal of respect and support for what Secretary Cisneros does. I think he does a tremendous job, having lifted HUD to a height that it needs to be for the era in which we live where there is such a great need.

Yet, there would probably be many who would be concerned about the delegation of responsibility given that the Secretary of HUD operates based upon who is in the White House and upon the appointment. How do we assure there is a creative means by which we protect the agency and the interest of the agency in this regard regardless of what administration happens to be in the White House at a particular time?

Mr. RETSINAS. Mr. Chairman, that is a very easy question for me to answer. Let me explain why.

I really need to look at all of you. The legislation, for example, governing the regulation of the GSEs passed in 1992 in the Banking Committee as well as your colleague committees in the other Chamber, periodically conducts oversight hearings on our performance of that regulation. I came to you last month, testified as completely as I could, disclosed all the information we had on the performance of the GSEs as it relates to a number of different issues. We held back no information.

Certainly, if in any way the Department was inappropriate in terms of information I am sure you would have been the first, despite your high regard for the Secretary, to let us know about that. That is one of the advantages of our system of government that has the checks and balances.

So I have great confidence in this subcommittee's oversight to ensure that, whoever is in the Department of Housing and Urban Development and in the White House, this subcommittee would undertake the necessary oversight of that responsibility.

Chairman FLAKE. OK. And your third function would be the delegating back to the Federal Home Loan Bank Boards the governance functions, is that correct?

Mr. RETSINAS. In large measure.

As I said to you, Congressman, I have already begun a process, Mr. Costiglio and I, reviewing the current operations to see within the confines of current law what could be delegated.

I don't want to come to the conclusion that everything can be delegated. For example, there still are certain debt issuance responsibilities that are appropriately centralized and coordinated through our Office of Finance. That responsibility would have to continue. It may take a different form.

So it is not a complete delegation but certainly a more substantial delegation than exists now.

Chairman FLAKE. Part of our discussions have been—you and I in the hearings and so forth—how to get the System to be responsive to one of the particular areas which, as you know, I have a great deal of concern and that is, even as we do housing production, the commercial strips in those communities that really need to be revitalized for job creation for stabilizing whatever housing we produce.

Do you see possibilities within these changes for addressing that particular need? And, if so, how might it be done, even within the constructs of safety and soundness?

Mr. RETSINAS. Absolutely. I think it is very possible.

As Director Costiglio mentioned, we believe that the System is well positioned to expand its mission. It can do so prudently. In some ways, it is already happening.

As you all know, the System now has a Community Investment Program that has gotten increasing use, but there is even greater potential. Much of that program is used to stimulate economic development. We believe, again, an affirmation of a mission, a statement of the import of community development lending, will further move the banks in this direction.

I might add parenthetically there will be other kinds of changes. The increasing participation of commercial banks. Many of them have more experience in economic development or small business lending. That will add value to this debate and shows positive examples of how these banks can engage in what we believe is prudent community development lending.

Our report gives examples of community development lending. We are careful not to be prescriptive. This is an area where I think one ought not to be prescriptive. One ought to be illuminating, show the potentials, the possibilities. There is potential for increased participation in those kinds of activities.

We all know and understand, Congressman Flake, what you understood for a long time. There is a nexus between commercial development and housing. If we just focus on one, we will constantly be falling behind. We need to find a way to be sure we proceed on both fronts. That is what we are trying to do with HUD, and we think the System has potential in that regard.

Chairman FLAKE. Mr. Costiglio, among the problems you worked at helping to develop, those you participated in in some way in terms of creation of affordable housing—as you know, in New York we have been successful in large measure because we gave opportunities for people who were working class, many instances blue collar, but who, because they lived pretty much hand to mouth, paycheck to paycheck, had not developed a great deal of assets.

Yet, when we worked on our partnership housing programs we were able to give them certain credits that allowed for the lowest downpayment possible while at the same time giving them reasonable opportunities by crediting them in New York because we did it as two and four families, by crediting them with the income from the potential renter.

Those have been successful programs. How do you see that playing out on the national landscape or is it possible that it could play out on a national landscape?

Mr. COSTIGLIO. It could very easily. I think there is basically not that familiarity with that type of lending. I came across it, some resistance to that type of lending in the middle part of the country where there was resistance to giving credit for the income from the other apartments in the structure. I think that that is wrong.

That gives somebody an economic boost, gives them economic independence. I think that that is something that we have to—we have to market, as a matter of fact. It is just a selling job. It may have to be eventually one on one, but, hopefully, we can do it through our delivery system that Nic mentioned. I think that that is the one thing we can do. We cannot only deliver money; we can deliver ideas.

Chairman FLAKE. I think maybe what we need is a study, and I think what we will demonstrate is that rarely, if ever, do you have individuals who find themselves foreclosed, have their mortgages foreclosed on. Because once that unit goes up and that rental unit is there—and you have been to my district. You know once those people moved in those homes they did everything possible to make sure that they kept those units.

And I think it is a good program. I think it is something we perhaps need to give some attention to. If it requires selling it in certain parts of the country, I think we have a model that we can sell.

Mr. COSTIGLIO. I think so. I see no problem with giving somebody an economic boost, giving them economic independence, and even building wealth. I think that that is important.

Chairman FLAKE. I think the key here is to make people understand. We are not talking about people asking for a handout. These are people asking for help in getting into the housing market, fulfilling their dream. And once they get in they will work hard to maintain and keep those homes.

Mr. COSTIGLIO. The two-, three-, four-family house is a very viable economic unit. I think we have to market it. As I said, I met resistance to the three-family unit in the middle part of the country. It is not right. I think we ought to get out there and market it.

Chairman FLAKE. Since Wisconsin is part of the middle part of the country, Mr. Roth, I present you for your questions.

Mr. COSTIGLIO. I wouldn't identify him that way. But it is a problem.

Chairman FLAKE. Thank you very much, Mr. Costiglio.

Mr. COSTIGLIO. Incidentally, we have another thing in New York that has helped a lot with this. We have mortgage insurance at the State level. I think that that is another element that we should look into. And possibly we have FHA, but that has already some structure to it. I think we need to reexamine the insurance programs.

Chairman FLAKE. I think that that—Mr. Retsinas—something we can take a look at.

Mr. RETSINAS. Absolutely.

Chairman FLAKE. I think that makes good sense.

Mr. Roth.

Mr. ROTH. I think because we have other panels I will wait for my questions until all the panelists are finished and maybe give questions in writing.

I will say in the Midwest we have a strong tradition of single-family home ownership. Maybe that is one of the reasons why there is some resistance, although we do have a good history as far as duplexes and fourplexes are concerned.

Mr. Chairman, the testimony this morning has been most illuminating. I think I will wait for the other panelists so that I can structure my questions and get the most out of the answers.

Chairman FLAKE. Thank you very much.

Mr. Richard Baker, who came on the Banking Committee with me almost 8 years now from New Orleans. We are happy to welcome you to the subcommittee this morning. Any questions you might have?

Mr. BAKER. Mr. Chairman, yes, I do. Certainly, I appreciate your courtesy in allowing me to participate in this hearing.

Let me, before I advance my question to Mr. Retsinas, frame the environment in which I am casting my questions this morning. I have been a strong advocate for modernization of the Federal Home Loan Bank System and have worked with Mr. Flake on past issues on expansion of credit opportunities for individuals in the inner city and particularly rural communities.

I envision a Federal Home Loan Bank System that is changing in nature because of, perhaps, factors beyond its control but perhaps to have a new mission that joins it with rural communities and inner-city borrowers for the purpose of extending fixed rate, long-term financing for those credit needs which in—some of my friends in the marketplace don't like this word—"cookie-cutter" lending that is required to sell off loans to the secondary market, since most of the Federal home loan bank advances are advances used by portfolio-type lenders who lend to the person or the community rather than a standardized credit form enabling it to be bundled with others and sold in the secondary market.

Having said that, I have been concerned over the past few years as to the condition of the System and its direction. Fortunately, because of interest rate yield curve benefits we had in the last 2 years, we have seen some of the declines in earnings be turned around. Yet, at the same time, we have not seen a growth in membership that has led to increased advances.

What I think we have seen is the nature of the System change from a very large System of many highly capitalized thrifts to a much more uniform blend of smaller commercial bank institutions joining with the residual smaller thrifts, have quite a different looking membership mixture. The problem is for the new members. They cannot borrow or get the advances on the same costs or terms as the thrift members unless they happen to be a QTL-qualified borrower.

One of the concerns for me is that the reason and logic for continuation of a QTL test—which is an issue for another day. But, at the same time, I am wondering as we begin to deal with the substance of this report whether we have really gotten anywhere. I am not making that statement as a criticism of the Department. The report is—was well past the date it was designated to be made.

And, second, skip to a really important question, one of which is the issue of permanent capital, for example.

We deal with the statement of RefCorp obligations by saying, as long as advances continue to increase, future RefCorp obligations will not be a problem. But we say we would like to discuss the concept of permanent capital perhaps by allowing sales of some new issuance that might be created. But in the discussions of the sales of that market product saying marketing of these securities to the public would only be viable if the system is expected to be sufficiently profitable.

I think the profits we see in the past 6 months, 12 months are primarily due to the unique and extraordinary interest rate yield curve environment we are now in, and no one can expect rates to remain down forever. If we find ourselves in a high interest rate environment at some future point, profits would again begin to deteriorate.

I looked, for example, at the San Francisco bank whom I look to hearing from later and recognizing they have had very little profits in the past, dividends to members up to 2 or 3 percent; and the reason for that is they have very few new commercial bank members. The members that are there do not borrow.

We are an operation that makes money by making advances. One small incremental step I have suggested in another committee hearing which was adopted which was increasing the non-QTL borrowing cap from 30 to 40 which has been the subject of some controversy. I do not understand it. That is allowing someone to make a product available, sell it, make money, and when they make money, the System makes a profit. That would then allow the thrift members in the System to make more earnings.

It seems to be logical, and, in fact, I would not only support 30 to 40 as a policy matter I think there ought not be a cap on what non-QTL members are able to borrow in the way of System advances, a view which I think the report does take.

On the other hand, I do believe we certainly need to move forward with modernization, not just voluntary membership, not just permanent capital. We need to look at QTL standards being removed from thrift members as well as encourage lending in inner cities and rural communities at "niche," a rather large one, I would presume, for the Federal Home Loan Bank System to meet those nonconforming credit needs which we find very difficult to meet given our current constraints and rules.

I guess my question is, if we are in the market for reform, why don't we go back to the Baker-Neal proposal that has been on the books—on the shelf now for 4 years that not only advocates removing the commercial—the consumer cap but advocates a resolution of the RefCorp obligation and talks about the new role for the Federal Home Loan Bank System?

I am very frustrated that even at this late date, after three very extensive studies, we do not have a plan that solves the problem. We are now talking about another year passing and not really meeting the substantive needs of the bank system nor enhancing credit opportunities for the individuals Mr. Flake and I are very concerned about.

Your comments?

Mr. RETSINAS. Several. I tried to keep track of the points. If I missed any, Congressman, please come back.

Before I do that, let me thank you, if I could, personally. I know we have had—in my mind—opportunities to talk about the System. I know you are one of the experts on the System. I appreciated that consultation. I hope you can see the report reflects some of that discussion in the light.

Let me walk through the points, some of which of related and some of which are different. If I don't cover them, follow up.

I certainly support your fundamental point, which is it is time to understand that this is a different day. It is a different day in 1994 than it was in 1932, as I said in my oral statement. There is nothing that has changed more than the world of housing finance, which is not to say there is no longer a need for Federal Home Loan Bank System. To the contrary, I think there is a need. I think there is a niche. There is a gap in the housing finance market that portfolio lenders can fill. So I think we are exactly on the same wavelength in terms of reaffirming that mission.

When we talk about an expansion of that mission beyond housing finance and community development lending, the underserved areas, the rural areas are part of that community development lending. Sometimes people think because of the nature of the name of our Department, Housing and Urban Development, we are referring exclusively to inner-city lending. That is not the case. This Department I think over the last year has a proud record of reaching out beyond that.

When we talk about an expansion of its mission, it includes both underserved areas in cities and underserved areas in rural areas.

Mr. BAKER. Let me interject. The CIP part of the Federal Home Loan Bank System is a model for community development programs. It far exceeds anything proposed in recent memory, and it does the things from nursing homes to firehouses. It ought to be a program that gets better recognition and ought to be encouraged more fully through whatever innovative ways we can. It works. It is an extraordinary achievement.

Mr. RETSINAS. I appreciate those kind comments.

Greater use of the program—I think the potential is enormous for that program. I think it gives a chance. I regard the Community Investment Program as an advance, if you will, for the kind—I mean that in a rhetorical sense—an advance for the kind of community development lending that I think the entire System could be more engaged in.

I appreciate those comments. We are trying to promote it. We are trying to promote it through certain incentive plans that we have vis-a-vis the participating members and employees of the System. We think there is a lot of potential. I agree with you.

As it relates to the role of the commercial banks, I think the evidence is not quite as clear in terms of who those commercial banks are. The statistics, however, are clear. There has been enormous increase in membership in commercial banks.

Several months ago, we reached a point where the commercial banks now outnumber the thrifts. While many are small commercial banks they are also some of our Nation's largest banks.

Yesterday, I was at the Federal Home Loan Bank of Pittsburgh. One of their most active members is PNC, one of the largest commercial banks in this country. I think that that is coming.

I also think you will see—and we have statistics to bear that out that I would be happy to share with you and—Mr. Chairman and members of the subcommittee—the increasing use of the advance window by commercial banks.

Has there been a time lag? Yes. Is that to be expected? Yes.

I think when members join the bank they are asking themselves the question: To what end? I think they learn its use and utility over time.

I happen to believe programs such as the Community Investment Program, the Affordable Housing Program are further reasons for participation. I think that that will lead to further use of the advances.

I think you can see a correlation between the participation of commercial banks and use of the advance window. There is just a time lag. That is, the membership by the commercial bank goes ahead of the use of the advance window. Our statistics indicate that those trends are positive and in the right direction.

Mr. BAKER. Would it not be beneficial to equalize membership requirements or so advances could be made on the same cost as that of the thrift? Because if you forget for the moment whether it is a thrift or bank member and are looking at the System's solvency as the primary concern, making more advances means more profit and the System does better. Would not that seem to be logical?

Mr. RETSINAS. I believe that is in our study. That speaks to it, as I recall. It speaks for voluntary membership and equalizing membership over time. So that is certainly consistent with the recommendations in the study as it relates to capital structure.

As I said before you joined the hearing this morning, that I wish I could say—I wish I could say we now have all the answers that relate to capital structure. But we do not. It is a consultative process. I believe that the system is dependent on its ability to attract and retain private capital, not just government capital.

If this were exclusively a government enterprise—not a government-sponsored enterprise but a government enterprise—then it would be easier, in all candor, Congressmen, to come forward and say, this is the answer. I truly believe that this is a process that needs to be done in a consensual and concentrated manner.

I certainly understand the administration has its own responsibilities and cannot delegate that responsibility in terms of coming out front. I also understand the Congress has an appropriate role in coming to the final conclusion of what kind of structure works. That is a work in process.

While that work was not completed, I did not want to further delay the study. We went forward with the study. Given the outline of the parameters, of the direction, but not all the answers—I don't think it was right for us to try to give all the answers—that is not the kind of administration I envision in how we work together on a consensual basis.

In terms of the issue of—back to the mission and the role in terms of nonconforming loans, one of my frustrations with the System is getting adequate, substantiated, demonstrative information on how currently the System carries out its mission. I am not talking now about the Community Investment Program. I am not talking about the Affordable Housing Program. That is pretty clear. The records on that are clear.

I am talking about the general use of advances, the 100 million. I issued a challenge for the industry and 12 regional banks to answer the question: What lending is taking place? What markets are they serving? What niches are they serving? What gaps are they filling? Not because there is a dissatisfaction but because I believe there is tremendous potential in the system.

While we suggest in the report that the best way to ensure that takes place is the enhanced use of an upgraded CRA Program, at the same time we acknowledge in the report that we may need other options. We may need the kind of oversight I referred to earlier in my response to Congressman Flake, the kind of oversight that ensures this housing and community development mission is undertaken. Because, in the end, this is the Federal Home Loan

Bank System. Therefore, it must achieve some public purpose to justify its existence.

It is that balancing of public purpose with the need to attract capital that is the challenge. It is a challenge we need to take on. It is a challenge that I can understand your frustration, but at the same time no one would argue there is a rush to judgment. We need to move forward.

I know there are some things we are doing administratively today that will move us in that direction. I think we are giving further recognition to the importance of community development lending. As I mentioned before, some of our activities now promote that.

Mr. BAKER. I would say I don't think anyone has ever accused anyone of rushing to judgment on this issue.

Mr. RETSINAS. That is good.

Mr. BAKER. We had 4 years of rushing.

Mr. RETSINAS. I am just here 1 year.

Mr. BAKER. It is not just—it is not critical of you.

Mr. RETSINAS. I understand, Congressman.

Mr. BAKER. I have no further questions.

I just feel, Mr. Chairman, it is time for the subcommittee, the Banking Committee, to grab hold of this. There are a number of issues the Bank System provides us to work together on inner-city lending, rural lending, the CIP Program, rural housing. I am convinced that if we can equalize membership, modernize the structure, we can provide capital not only for the important programs you are interested in, Mr. Chairman, but we can do things that will help the Bank System itself be able to pay dividends to its members. That is really sort of an interesting thing to think about.

Mr. RETSINAS. It is a win-win.

Mr. BAKER. Yes. I am hoping to bring more attention to the subject. I appreciate your calling these hearings.

Chairman FLAKE. Thank you very much. Thank you for your interest.

My staff and your staff have started some discussion. Clearly, it is an area of great concern for me to move the process, and I think that as we have the marriage of our staffs perhaps we will have to just move forward in the best possible and most expeditious way to make sure by the time we have another major Banking bill that we can address adequately this issue.

Again, it is not just an urban issue. It is rural. I think all of our communities—if we can rebuild now, the future looks much brighter than does the present. Certainly, we can overcome many of the mistakes of the past.

Thank you very much, Mr. Retsinas and Mr. Costiglio. Good to see you both. Thank you for your responses.

You, certainly, are invited to stay to hear the other witnesses if your schedules will permit that. Perhaps you will discover that you are on the same page or you may not be. So you may do so if you would like.

We will call a recess for the moment so we might change you and place at the table those persons on our second panel.

Thank you very much.

Mr. COSTIGLIO. Thank you.

Mr. RETSINAS. Thank you.

Chairman FLAKE. We will call to the table now Alfred DelliBovi, president of the Federal Home Loan Bank of New York; Gerry Champagne, representing Mr. Michael Jessee, president of the Home Loan Bank Board of Boston; Dean Schultz, president of the Home Loan Bank Board of San Francisco, who has been before us in the past; and James Faulstich, president of the Federal Home Loan Bank of Seattle.

Let me begin by thanking each of you for responding to our invitation,realizing that you basically sit at the cutting edge of what really can happen in trying to rebuild our Nation, trying to lift up those communities where we realize there is vast potential that in many instances has been overlooked and tap into this field of opportunity that is available to us.

I thank all of you personally, especially Mr. Al DelliBovi from New York who has been so liberal in his time to come out to share in my district and to be with us in other occasions, knowing that you canceled an engagement today so you could be with your wonderful colleagues from other parts of the country. And we did not want you to be here alone. I want to thank you very much.

We will start in the order you are seated at the table, with Mr. DelliBovi.

We will invite you to give summaries if you wish, and we will accept your full statements for the record. And then we will come forward with a round of questioning from those of us who are represented this morning.

Mr. DelliBovi.

STATEMENT OF ALFRED A. DELLIBOVI, PRESIDENT, FEDERAL HOME LOAN BANK OF NEW YORK

Mr. DELLIBOVI. Good morning. I am Alfred DelliBovi, president of the Federal Home Loan Bank of New York. I appreciate this opportunity to comment on the HUD study and possible legislation impacting the Federal Home Loan Bank System.

I would ask my entire statement be placed in the record, and I would like to take a few moments to hit some of the high points, if that is agreeable.

The New York Bank is in full agreement with the two central conclusions of the HUD study: One, that portfolio lending in support of mortgage financing is critically important, and; two, that support for mortgage portfolio lenders should remain the core function of the Home Loan Bank System.

Through our 265 community-based shareholders, the New York Bank plays a key roll in hundreds of communities in our district which includes New Jersey, New York, Puerto Rico, and the U.S. Virgin Islands. Similar economic contributions are being made by the other 11 home loan banks.

The System works well and, as the HUD study tells us, it is needed, and it is not broken.

While we look forward to working to develop comprehensive legislation in the future, however, we are in business today. Today, we and local lenders should enjoy the benefits of a few legislative changes that common sense and reason dictate are needed. To this end, the board of directors of the Home Loan Bank of New York last week adopted a legislative agenda which is included in my full testimony.

During deliberations on these legislative objectives and other comprehensive legislation that may be considered in the future, it is critical, we believe, to ask, if you will, the 15th question, the question that was not asked by the Housing and Community Development Act in 1992, the question that none of the studies addressed. That question is, how do portfolio lenders with the support of the Home Loan Bank System do their business?

Portfolio lenders are in business for the long haul. They are often located in the very heart of their communities. The community lender is there to help finance a loan for his or her neighbor. He or she is there to take deposits and offer savings accounts. And they are there to cash checks to make car loans, personal loans, to keep valuables safe. In short, they serve to meet many of the diverse financial needs of their communities.

The ability to accept as collateral many types of mortgages has enabled the home loan banks to offer a unique foundation, a foundation from which local lenders can play their key role in neighborhood building. With our flexible policies, we can lend against a wide variety of creditworthy, mortgage-related collateral. This flexibility has, in turn, enabled portfolio lenders to meet their customers' varying financial needs.

A great many of our local member lenders holding a mortgage on a one-to-four family residence with a small business, maybe a health care facility, a dry goods store—Mr. Chairman, the kinds of buildings scattered all over your district that is attached to the home—these types of one-to-four family properties typically do not fall within the guidelines of the secondary mortgage market.

We also accept conforming collateral like the two-family home with 21 boat slips in Suffolk County or a bed and breakfast in upstate New York.

Some of our portfolio lenders serve culturally diverse communities with different standards and practices for loan documentation. As a consequence, those mortgage documents do not conform to those of the secondary mortgage market, but they do represent very sound business.

Another significant area of support from the home loan bank is for mixed-use multifamily properties. Let me just mention a few typical examples we have in our collateral vaults.

In the Bronx, we accepted Oliver Gardens as collateral pledged through advances. This is a mixed-use building with 43 co-op apartments, like so many other buildings in New York City, with a small business on the ground floor.

In Ulster County, New York, in Mr. Hinchey's district, we have as collateral a property with nonconforming blanket mortgages covering a three-story building with eight apartments, a one-family cottage and two garage buildings with nine repair bays.

Similarly, in Orange County, New York, we have as collateral a five-unit apartment building with documentation that would not comply with the cookie-cutter requirements of the secondary mortgage market.

I had that line in there before you used it, Mr. Baker. The fact is, it was there.

This flexibility in the types of collateral we accept allows local lenders we serve in Puerto Rico to pledge 720 home loans originated under various housing programs sponsored by the Commonwealth. These also would not fit into the secondary market.

But our community lenders do not make only unusual mortgages. The basic multifamily residential mortgage is a key part of the business strategy of many of the members in the New York bank district. Because of the special housing requirements of our metropolitan communities, our members have developed special expertise in multifamily lending. This is especially important in this sector of the residential market because it is so clearly underserved by the secondary market.

In fact, the multifamily mortgages that banks and thrifts hold in their portfolios total 3½ times all multifamily mortgage securities outstanding. Let me repeat that. If you looked at the entire amount of securitized multifamily mortgages, what we have in thrifts and banks is 3½ times that amount. And the ability to pledge these mortgages at the Federal home loan bank is a major factor in maintaining the flow of mortgage funding to this vital sector of the housing market.

Mr. Chairman, Mr. Baker, Mr. Roth, this is community development lending. This is what our members do every day. The portfolio lenders who do this kind of lending have relied on the Federal home loan banks to serve as an integral partner for over 60 years. Through our programs we ensure a flow of capital from Wall Street to Main Street.

We are eager to work with you to help ensure that the financing needs of all American home buyers are met and continued. We are ready to go back to business because we are in business, as I said earlier, today and every day.

Thank you.

[The prepared statement of Mr. DelliBovi can be found in the appendix.]

Chairman FLAKE. Thank you very much.

I have one question of you right now, Mr. DelliBovi.

Places like New Jersey where I visited with you, the New Community where they did the Pathmart supermarket, the printing shop, the eating—food court—all of that, is that the kind of lending? Are you part of the package of that kind of lending for that particular entity?

Mr. DELLIBOVI. The New Community Corp., uses a variety of sources of lending. They use some of our programs. The New Community Credit Union is now a member of the Federal Home Loan Bank of New York, assembling assets.

As Monsignor Linder, chairman of our Advisory Committee likes to point out, when you look at all the sources of funding that went into that Pathmart, there is almost no kind of money that did not go into it.

But more importantly than the funding that went into the supermarket is the housing right around it that is a part of our Affordable Housing Program and other programs. So we are part and parcel of that.

More importantly, our members, who make a profit because we exist, are able to contribute to those kinds of efforts and take a lesser profit on those kinds of projects because we make them profitable.

The important thing to remember about the Home Loan Bank System, I think, is that our members do not originate a mortgage as the mortgage bankers do and they try to find a funding source for it. Our members use the home loan bank to fund an entire balance sheet because they are in the neighborhood all the time. They do not have the little storefront offices that they can close up when the rates go the other way or they get bought out. Our members are in the community for the long haul and use us as a financial partner for the long haul.

Chairman FLAKE. Thank you very much.

Mr. Champagne, my regards to your president. He has been before the subcommittee before. Thank you for coming today to give testimony on behalf of the Bank of Boston.

STATEMENT OF GERARD J. CHAMPAGNE, REPRESENTING MICHAEL A. JESSEE, PRESIDENT, FEDERAL HOME LOAN BANK OF BOSTON

Mr. CHAMPAGNE. Thank you Mr. Chairman.

I am Gerry Champagne, executive vice president of the Federal Home Loan Bank of Boston. On behalf of the bank's CEO, Mike Jessee, I am pleased to summarize his written statement concerning recently published studies on the Federal Home Loan Bank System. Unfortunately, Mike had a longstanding commitment which could not be rescheduled.

Mr. Chairman, we appreciate your interest in the Bank System and express our sincere thanks to you for holding this hearing.

I will not repeat the information discussed earlier about the successes the System realized with the Affordable Housing and Community Investment Programs and the success we had in attracting new commercial bank members. I think it has been adequately covered by you and Secretary Retsinas.

With respect to the five studies, it should come as no surprise there were differences of opinion. However, more interesting in our view were the many areas of consensus.

Each study stresses the need for the System to maintain its traditional focus on lending to member institutions.

Each study also supports a threshold commitment to residential lending in order to become a member of the System.

The Boston bank concurs with these two findings. All of the studies support a single, uniform set of rules for all members. All agree membership should be voluntary, but some expressed the view an all-voluntary membership approach should be linked to the creation of a permanent capital base.

The Boston bank strongly endorses equal access for all members. The bank supports voluntary membership to the System. In addition, we believe that universal voluntary membership is feasible even with no change in the System's capital structure.

With regard to the System's capitalization it is our view that the System's capital is more than adequate at the present time. We do not see a critical need for restructuring the System's capital, although enhancements such as tying the System's level of capital to its risk and crediting a new layer of permanent capital may have merit.

However, this issue requires a great deal of additional study and analysis before a definitive position can be taken.

The studies also support separating the Finance Board's dual responsibility for governing and regulating the 12 banks. The Boston bank has long been a proponent of separating governance from regulation. We believe that the business management and corporate governance of a bank should be vested in each bank's board of directors.

Members of the Boston bank range in size from $10 million to $13 billion in assets. They serve a broad range of communities from Connecticut, Massachusetts, Rhode Island to rural communities in Vermont, New Hampshire, and Maine. Our 373 members are active lenders in their communities. Together they hold over $73 billion of residential mortgage loans in their portfolios.

In addition to our participation in the Affordable Housing and Community Investment Programs, the board of directors of the Boston bank recently approved a new initiative entitled "Grants for New England Partnerships," or GNP, which will provide grants of up to $3,000 each to help fund the efforts of nonprofit agencies selected by our members for their achievements in affordable housing or community development activities.

A second initiative involves a partnership with the Massachusetts Thrift Fund, a State-sponsored loan fund, and the Boston bank. The program entitled the Massachusetts Community Building Program will provide an estimated $25 million in subsidized loans to Massachusetts members for qualifying projects. The subsidies will be as high as 300 basis points for residential and economic development projects that target households earning less than 50 percent of median income.

We are also quite proud of our relationship with the New England State housing finance agencies. Four of the six State HFAs have been approved as nonmember borrowers, and a fifth applied for nonmember borrower status.

The Boston bank was the first to lend to a housing agency, providing a line of credit to support a reverse annuity mortgage program for low-income elderly citizens of Rhode Island. In addition, the bank has provided long-term advances to both the Massachusetts and Rhode Island FHAs to support multifamily preservation projects occupied by very-low and low-income families.

Finally, we organized a task force with the New England HFAs to identify ways in which we can participate in the Preservation and Risk-sharing Programs between HUD and qualifying HFAs.

These initiatives clearly underscore the Boston bank's commitment to affordable housing and community development.

Finally, Mr. Chairman, we would like to discuss certain amendments to the act included in the House version of the Community Development and Financial Institutions Act. These amendments were offered by Congressman Baker. Mr. Baker has been a true champion of the Home Loan Bank System, and his efforts to legislate changes which will allow the System to more effectively meet community lending needs of our members are widely recognized and greatly appreciated.

The Boston bank supports the amendments offered by Mr. Baker and urges the House and Senate conferees to include those amendments in the final bill that is sent to the President for his signature.

Some have argued that the Baker amendments constitute piecemeal reform of the System and for that reason should not be supported. Proponents of that view maintain that what the System needs is comprehensive legislation.

We fail to understand the logic of that position. While supporting the Baker amendments, we also support comprehensive legislation. It is our position that passage of the Baker amendments will enhance the System's mission and, most important, provide additional time to develop comprehensive legislation in a rational manner.

Although we support all of the amendments, I would like to make several points regarding the amendment raising the ceiling on advances to non-QTL members from 30 percent to 40 percent of all System advances.

The current ratio of advances to non-QTL members lies somewhere in the range of 8 to 16 percent.

While there is little in the way of historical trends in this area, it should be noted that advances to commercial banks doubled in 1993, and there continues to be the potential for advances to commercial banks to grow exponentially.

At the Boston bank we concluded that nonthrift lending could exceed 30 percent by late 1995. We consider that projection to be reasonable, given the fact that commercial banks now hold more residential mortgage assets than savings institutions, that commercial banks are the fastest growing segment of the bank system's membership and the propensity of these new members to borrow advances.

However, that does not preclude the ratio from crossing the 30 percent threshold earlier or later. There are just too many factors, none of which the Bank System controls, that influence those ratios. The very existence of a lending cap in the face of such uncertainties is what causes us the most concern.

The modest change proposed by the Baker amendment provides additional lending capacity to the System while more comprehensive legislation is being considered. It is difficult to understand how the System and its shareholders would benefit from being forced into an arbitrary credit allocation which is totally unrelated to the housing finance activities of its members.

On behalf of the Boston bank, I would like to thank Chairman Flake and the other members of the subcommittee for providing the bank with this opportunity to express our views of these important matters.

[The prepared statements of Mr. Champagne and Mr. Jessee can be found in the appendix.]

Chairman FLAKE. Thank you very much.

Next is Dean Schultz, president of the San Francisco bank, who has over the last few years certainly done some very creative financing, worked out some processes that allowed for development in areas that I have a great deal of concern with, and to commend you, first of all, and welcome you to the subcommittee and look forward to your testimony.

STATEMENT OF DEAN SCHULTZ, PRESIDENT, FEDERAL HOME LOAN BANK OF SAN FRANCISCO

Mr. SCHULTZ. Thank you, Mr. Chairman.

Mr. Baker, Mr. Roth, good morning.

I would like to thank you for the invitation to speak on the subject of the HUD study. I offer my comments in the context of an ongoing commitment to the financial strength and public purpose success of the System.

HUD addresses the Federal Home Loan Bank System with three recommendations: It suggests a new mandate for lending to low- and moderate-income families and for community development; suggests the creation of permanent capital and a capital standard; and examines equal access and stock purchase rules.

I would like to address each of these topics and give you points of agreement and disagreement.

First, let me talk about the mandate for lending to low- and moderate-income families and for community development. We agree very strongly with the overall focus on portfolio lenders in the HUD study and the System's goal in supporting these lenders. We believe there is a huge amount of anecdotal evidence that can be amassed to indicate a greater role on the part of portfolio lenders in supporting their communities than is currently present. We hope that effort will be undertaken.

We also agree strongly with the emphasis on the need for a strong, financially sound Bank System. We applaud HUD's unwillingness to require changes to the collateral rules to advance other goals.

In addition, I am extremely pleased to hear Secretary Cisneros refer to the balance in the System, the need to earn and pay an adequate return on private capital that funds the System and, at the same time, meet the requirements of its Federal charter. This is a balance that is very, very difficult to maintain, and it is critical that it always be maintained.

We agree that this mandate does not require development of new products and lines of business that would increase risk in the System, and it does not require expansion of membership outside the regulated financial institutions that are currently allowed to join.

HUD soundly rejected the idea of securitizing loans which would lead to three GSEs in that business and rejected the idea of direct lending in the construction area, in which those with lots of experience suffered lots of losses. There is no reason to think the Federal home loan banks would do better, and as a startup business we would most likely do worse.

We disagree with the fall-back position in the HUD study which discusses the concept of targeting advances in some fashion. We have to begin with the recognition that we do not control what lenders do. We are wholesale lenders. Our shareholders do the retail part. We support them in their activity.

When I read Jim Johnson's testimony before this subcommittee, it was clear that the difference between Fannie and Freddie and the Home Loan Banks is that Fannie and Freddie buy loans. Everyone knows exactly what is financed. The Federal home loan banks' money is fungible. We make our loans, and the shareholders conduct their own activities. We are here to support the activities of the portfolios lenders and to provide liquidity so they can engage in their business. We enable them to turn the loans in their portfolio into cash.

HUD's first focus is on CRA. We believe that that is the appropriate place to focus as opposed to targeting advances. The primary reason for that is that the debates as to CRA can occur and be engaged in directly by the lenders themselves—rather than indirectly through the targeting of advances.

We are primarily a source of liquidity, and the targeted advances concept also places that function in danger by making us less reliable as a source of liquidity.

It is sometimes said the most valuable loan to a shareholder may be the loan that is not made. The shareholders last year in the survey done in connection with System 2000 said liquidity was the most important thing the System offered.

The Federal home loan banks permit lenders to hold less liquidity and more mortgages. We also let them hold more mortgages simply because we can lend to them and match their funding more closely than can their depositors. If we are required to lend in a targeted manner, there may not be funds to serve for liquidity, and the lender may not be able to provide the assurance that the targeted lending has been done or will be done. That would lessen the value of the membership and lead to less affordable housing.

A final point on this topic is the System cannot get smaller than it is and still maintain the balance we have discussed. Shareholders must receive a reasonable dividend, something more than they would get if they had invested in a Treasury bill or bond.

Any restriction on advance use isn't likely to increase membership or increase advance volume. Instead, it is likely advance volume would decrease, and the decline in advance volume would have to be made up in investments in order to maintain the System and individual bank income at a level that enables the bank to pay their RefCorp charges, $100 million for AHF, $200 million for operating expenses, $20 million for FHFB assessments, and then a reasonable dividend on the capital invested in the System.

The result of HUD's fall-back position on advance targeting would likely be there would be an increase in mortgage-backed securities portfolios in the System as a result of declining advance volume and declining income. Of course, you could address the RefCorp charges and make them a percentage of income as recommended by the GAO and deal with part of this issue.

The second topic in the HUD study was creation of permanent capital and the capital standard. I would like to begin by putting this concept into perspective. The CBO and the GAO say the System needs permanent capital for two reasons.

First, there is what is identified as membership risk. That is the risk of members leaving if membership becomes voluntary.

The second is the argument that the sum of the capital of insured depository institutions and the Federal home loan banks is less than the sum of the capital of each of those institutions aggregated, because the capital in the banks is financed.

HUD agrees permanent capital is necessary. Underlying this is a desire for the System to remain viable. The RefCorp charges must continue to be paid.

The question you have to ask yourself is whether somewhere around $3 billion would be enough permanent capital because it is ironic that this was the amount of retained earnings the System lost in the original funding of FICO and RefCorp under CEBA and FIRREA. Prior to FIRREA, the banks were required to set aside 20 percent of their earnings into a retained earnings account, and this set-aside was to continue until the retained earnings account equaled the amount of stock outstanding.

The original creators envisioned a retained earnings pool equal to the stock, which would have been earned, permanent capital. What we have in the quest for permanent capital is a problem created as a result of FIRREA in that voluntary membership was created and retained earnings were taken at the same time.

I urge the Congress not to create another problem by fixing the earlier problem in a way that somehow injures some or all of the banks.

The third topic involved equal access and stock purchase rules. We agree all members should have equal access, equal ingress, and egress in the System, and have the same stock purchase rules. We believe voluntary membership is, in fact, necessary and inevitable because of the different incentives created for voluntary and mandatory members and, basically, because of the unfairness of the existing two classes of shareholders.

With respect to governance, we concur with the finding in the HUD study. There should be a separation between management or governance and regulation, and the safety and soundness regulators should be strong and capable. There are several candidates for that. We focus our thoughts on this subject more on what should be done by the regulator, as opposed to who it should be.

Program regulation, we believe, would need to be defined very carefully. The whole concept needs to be explored very carefully. Do we really need one? Can program regulation be done by the safety and soundness regulator? Can the program that is to be regulated be sufficiently defined so that it can be put in statutory form and carried out as a safety and soundness regulation issue?

We believe, pending the comprehensive reform the System needs, the administration would be wise not to fill the Federal Housing Finance Board seats and let the final form of the System's regulatory structure be clarified.

Finally, I would like to comment on the Community Development Bank bill and the Federal home loan bank amendments.

First, let me say we have consistently applauded Congressman Baker's continuing interest in the System. It was his comprehensive reform package several years ago you referred to earlier that led to much of the ongoing debate about the System. I believe he hit all the important issues in that legislation.

We have argued for quite awhile now that the reforms of the System are linked and should not be attempted to be accomplished sequentially. We believe that the membership rights and burdens are not equitably allocated in the System now. HUD says the System needs to be managed equitably. We believe, basically, reform of the

System must be undertaken in a comprehensive way, and the issues related to RefCorp, to voluntary membership, to access and to stock purchase requirements should be addressed simultaneously.

That concludes my comments, Mr. Chairman. Thank you very much.

[The prepared statement of Mr. Schultz can be found in the appendix.]

Chairman FLAKE. Thank you, Mr. Schultz.

Mr. Faulstich.

STATEMENT OF JAMES R. FAULSTICH, PRESIDENT, FEDERAL HOME LOAN BANK OF SEATTLE

Mr. FAULSTICH. Mr. Chairman, let me thank you and the subcommittee for inviting me here today. It is my pleasure. All the folks in the Seattle district are proud of my being here. They think that that is just great.

I would like to just summarize my remarks if I may, Mr. Chairman and Congressman Roth and Congressman Baker, and be able to respond, hopefully, if time permits, with any questions.

I would like, first, to acknowledge the tremendous efforts of Secretary Retsinas over this last year. He has been tireless in his working for resolution of the problems that have been identified with the Federal Home Loan Bank System. He has visited many of the banks, including ours. You heard just yesterday he was up at the Pittsburgh bank. He listened to us all very patiently. I believe he has learned.

We are anxious to be a partner in addressing the issues raised in the HUD Report. I am optimistic that working together we can hammer out a system that takes advantage of the unique strengths that the 12 Federal home loan banks and their 4,500 customer stockholders bring to meeting the housing and community development financing needs of our respective districts and our communities and neighborhoods in those districts.

The most important outcome of the five reports and studies of the System is the unanimous conclusion that the Federal home loan banks continue to serve a significant public policy purpose. I think that that is evident in the fact that we have voluntary stockholders, some 2,500, who have committed hard dollars in the billions to our banks as a vote of confidence in the continued significance of the System.

However, we all know and have talked today in various forums that one-size-fits-all home financing simply does not work in many, many, many cases. I guess our district is one example of that.

Our district—including Alaska, Washington, Idaho, Montana, Utah, Hawaii, and Guam—is the largest district in terms of geographic size in the Nation. In fact, it is one-third of the geographic land mass of all the United States. It has but 5½ percent of the total population. That presents some unique problems and challenges.

On our Affordable Housing Council, as an example, we have a representative from Guam who, on occasion, finds it more convenient and quicker to fly through Tokyo on his way to a meeting in Seattle; so that is a long distance for him to come. We have a member of the Navajo Indian nation from southern Utah who takes two buses for a total of 6 hours before he gets to the airport to fly to Seattle. So it is a broad district in terms of geographic challenge.

Chairman FLAKE. You do get to go through Tokyo.

Mr. FAULSTICH. Not when you're coming from southern Utah. We have Native Americans, Native Alaskans, Native Hawaiians in our district, all having unique challenges in trying to provide adequate and decent housing in their areas. We have working poor and elderly in urban Seattle as well as farmworkers in our more agrarian and rural areas of our district.

That the housing finance system is as diverse as the housing needs in this Nation seems to me appropriate. That is what the Federal Home Loan Bank System makes a unique contribution in providing.

The last 2 or 3 years, I have had the privilege and pleasure of serving as Chair of the Bank Presidents Housing and Community Development Committee. I am pleased to report to you, as you have heard already, that we have developed 27,000 affordable housing units in the Nation, 6,000 in our district alone.

Seventy percent of those that have been completed are rental, and 30 percent are owner occupied. Sixty-four percent of the affordable housing assisted units are for the very low-income persons; that is, those persons making less than 50 percent of median income, the very, very poor. In fact, many of those units have been developed for homeless people.

I did a recent survey in the Seattle district which is representative, really, of the Nation. In the Seattle district alone, 1,600 units were developed for homeless individuals that would otherwise be living under bridges or on the streets.

The Community Investment Program, you heard about that and the wonderful work it has already done, as well as the potential. In the history of the CIP, since 1989, we have lent $4.5 billion on a variety of projects, firehouses, tire repair shops, whatever. It is a flexible, highly flexible, highly, highly functional program.

I think, however, beyond the dollars that are contributed to the AHP or the CIP, as they are known, the most important role the Federal home loan banks play is serving as a catalyst to bring together the neighborhoods and communities, the nonprofits in those neighborhoods and communities together with the lenders in those communities.

You heard about the vast territory we have in our district. Only a handful—literally a handful of counties are not served by a customer or stockholder of the Federal home loan bank in Seattle. Having worked with those customer stockholders and identifying community groups with which they can work, I think that that is the true value of what we are able to provide in rebuilding our communities and neighborhoods.

The outreach efforts each of the banks have undertaken and the diverse outreach efforts each of the banks have undertaken underscores the importance of empowering each of the banks and their boards of directors so they can develop innovative programs that are responsive to the needs of their regions, communities and neighborhoods. Each of the banks have developed unique and different programs that have already done this within the constraints of existing authority.

You heard about the New England programs. In Seattle, as an example, we have developed what we call the challenge fund which provides predevelopment funding to community groups working with a local lender to do the necessary predevelopment costs that—without which you really cannot make an application to get the AHP or CIP monies. This has developed capacity in rural areas which otherwise would have lacked that capacity to develop that kind of funding.

What works in one area of our country does not necessarily work in other areas of our country. That is why we really need a regulatory structure that encourages that local innovation and experimentation. Accompanying this should be appropriate delegations of authorities so the respective boards in the regional banks can be authorized, held accountable, and be responsible for developing responsive products and services for their customers.

Let me close by urging you and your colleagues to remain mindful of the irreplaceable contribution our customers, the community-based financial institutions, make in all of our communities in ways large and small.

For example, First National Bank of Eureka, Montana, pulled together an economic development council when their town was threatened by the closure of a timber mill which provided the only source of industrial-based jobs in that town.

When Hurricane Iniki hit Kauai, the institutions reacted with care and concern. American Savings Bank, as an example, established a fund to collect donations and granted 3-month extensions without penalty on all consumer and mortgage loans. They also made $10,000 loans on a signature loan while the victims of that hurricane awaited the insurance proceeds.

It ranges even to maybe the sublime. In Seattle, Metropolitan Savings, a little savings bank, stepped in to sponsor a local carousel at Christmas time that was used to raise funds for the homeless and the needy in that area. It has come to symbolize the holiday season in our city.

I doubt very much communities banks without roots in their communities would have responded in such a way. I doubt that very much.

As you consider possible reforms to the Federal Home Loan Bank System, I would encourage you to consider what those changes will mean to those community-based financial institutions.

Thank you very much.

[The prepared statement of Mr. Faulstich can be found in the appendix.]

Chairman FLAKE. Thank you very much.

Thank all of you.

I think one thing all of us on this panel agree with is that banks in your system have not abandoned communities and are able to do an extraordinary job to the degree that they have not been prohibited by law and to make loans for other people not simply because they are in a position not only to do the traditional safety and soundness type loans but we talk about character loans. I think the community banks do that better than anyone.

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Mr. Schultz, you mentioned in your testimony that we should not fill the seats on the Federal Housing Finance Board at this time. Am I correct in that?

Mr. SCHULTZ. Yes, I did suggest that, sir.

Chairman FLAKE. I would like to know—I will ask several questions and get all of your responses to it.

First of all, without those seats being filled, how is the Housing Finance Board functioning without a quorum? Does the lack of a quorum impede the progress and the ability of the system to work? What would be done in case there is a crisis since there is no quorum there?

Mr. DelliBovi, in your statement you mentioned that two board members should be—in your written testimony—that they should be given full authority to act as a full board temporarily. And to that I would ask the question: What would they do that is currently not being done by virtue of having that temporary authority?

If each of you could comment to the question that is raised by the statement that you made, I would appreciate it for the record.

Mr. SCHULTZ. Mr. Chairman, the one issue I am aware of that has arisen with respect to the absence of a quorum is the expansion of funding authority for the issuance of consolidated obligations. I believe that the Finance Board staff is working now to try to understand ways under which consolidated obligation issuance authority could be expanded, given the lack of quorum at the Finance Board. I am hopeful they will find a way to deal with that.

In addition, though, the System has, by virtue of making arrangements with respect to its funding demands, determined that it can go through the end of the year without expanding funding authority. I am not aware of other issues that have arisen that have been delayed because of the absence of a quorum.

Chairman FLAKE. Mr. DelliBovi.

Mr. DELLIBOVI. Mr. Chairman, we are not aware of any issues. Probably, when we become aware of one—and I hope we do not—then we will have a real crisis on our hands because there is no quorum.

I sympathize with the administration's difficulty in finding someone to take a job that they do not know whether it is full time, part time, whether comprehensive legislation will do away with it. The recruiting efforts, obviously, are very difficult in this environment.

Therefore, our recommendation is, until the—until you can decide whether this agency is going to be around—if it is around, it is part time or full time—why not empower the two people that you have, let them be a quorum? We have clearly legislation moving on a system in the Community Development Banking bill. We feel that that would be an appropriate place to do that. Then you can deal with it in the comprehensive legislation permanently and proceed to recruit at that time.

We think a temporary solution of empowering these two would safeguard us. This issue with the obligations, whether we can issue more, regardless of what the staff comes out with as a decision, there is probably going to be something else.

I think the old board was very skillful in anticipating as many needs as they possibly could. I don't think they anticipated that this would go on as long as it has.

Chairman FLAKE. Would I be correct in assuming this is really not something you would want staff to have the full responsibility for, ultimately? It would seem to me you would want a board to have some validity?

Mr. DELLIBOVI. Absolutely. We wouldn't turn it over to the staff, Mr. Chairman. We just think there are two members of the board, both of whom have been confirmed, both of them appointed by Presidents, one of one party, one by the President of another party. At least they are sensitive to the System and understand it.

It is not a perfect solution, but now we have a situation where, even if both of them agree—as a matter of fact, if both of them agree and the other three that resigned agree, we still cannot change a policy that makes common sense because there is no quorum.

So it is a Catch-22 we are in. We would like to be out of it. Ideally, we would have the comprehensive solution that we do not have. We need to proceed.

As I mentioned in my testimony, we are in business. If we do not have the tools to do our business, we are going to be in serious trouble.

Chairman FLAKE. I think what we would want to do as a subcommittee is probably at least address the White House on taking a look at and the potential for crisis and what would happen if there is one and perhaps do some analysis of whether it would—they would accept your recommendation of leaving the positions vacant or whether it makes sense for them to move forward.

I would hate to think that such a potentially devastating situation—a potentially devastating situation could develop, and we would not be in a position to handle it, and at least the White House would not be on notice that we had some discussion on it, and it was not brought to their attention. So at least I think they ought to at least know. Then we can make some decisions about what is the best way to go in resolving this question.

The question—one of the questions before us now is one that is being addressed by the regulators, for the most part, and that is the amending of the salary requirements.

Now I must say that, in the instances of your banks, in many instances, you have done things that, by definition, CRA is designed to address but was not done because it was a CRA requirement. I certainly appreciate that and hope that you will continue to do it and continue to expand in that area.

But as we get into trying to address what ought to be done in addressing, targeting low- and moderate-income neighborhoods under CRA, the question is, what reforms do you think are definitely imperative to be inclusive as a part of whatever CRA reforms take place?

Another part of the question that is not directed at CRA but is much more parochial, as you know, HUD has not been in the business of building public housing, which is, in large measure, responsible for the number of persons who are homeless.

I have always argued that if we do not find ways to get people out of public housing, we will continue to exacerbate the homeless crisis because, historically, public housing was a short-term solution for those persons who had needs.

Is it possible for your banks to take a look at the means by which we create a product that gives credit analysis based on the payment records, the ability of people to handle their other bills, who live in public housing where in places like New York, Mr. DelliBovi, they are paying $700 to $800 a month—many people think they live free, but they don't—but could afford to pay a mortgage if we allowed them to use a product to have their downpayments reduced, to get them into housing, into the home ownership cycle and, therefore, open up new possibilities for those people who are part of the homeless population?

I would just like your comments on those two issues: One, CRA and necessary reforms; and, two, what can be done to open up the housing spigot again so we create opportunities for many people, particularly those in public housing who cannot afford to pay a monthly mortgage by virtue of what they are already paying if they had a product that met that particular need.

Mr. DelliBovi. On the CRA, one recommendation we have—and we are supported in this by the New Jersey League of Savings Institutions because, through the Home Loan Bank of New York, the New Jersey League organized a consortium, the Thrift Institutions Investment Corp., which is a consortium of lenders all over the State of New Jersey that make loans, originate loans through one of their local members in inner-city areas.

The problem that consortium has encountered is that institutions that were members who may be located in the suburban parts of New Jersey, when they make a loan through the consortium in Newark or Camden they do not get CRA credit because that is out of their service area. They are not taking deposits in Newark or Camden. They are far away from there. They like to make investments in partnership with local institutions.

We believe that that would be a change to the Community Reinvestment Act that would enable loans and target low- and moderate-income neighborhoods designated by an appropriate State authority, not all over the State, but let's target certain inner-city areas. We all know where they are. Let's give credit when somebody who is not in there makes a loan in there even if they are only making part of the loan. That would be one reform.

The second reform which—it is interesting you raise the question because, in the context of the Federal Financing Board's lack of a quorum, the New York bank proposed something called the First Home Club which would enable us to take a portion of our affordable housing subsidy each year and make it available directly to our members who would use it for families whose income is 80 percent below the median.

These families are the people you are describing who live in public housing. They may live in private housing. They pay their utility bills, their rent. They are earning a living, but they cannot scrape together the downpayment or only scraping together part of it. We propose to use our AHP money on up to $3 for every dollar they save on a matching basis.

So, under the First Home Club, a family would go to one of our member stockholders, go through a counseling program, make sure their finances are in place, begin a systematic savings account program at one of our stockholder institutions. When they reach the targeted level, about one-quarter of what they need, we would then like to use your affordable housing subsidy to match that so they could get into home ownership.

This proposal has been widely embraced by our stockholders. It has been applauded by people at all levels of our Advisory Council. Because we do not have a quorum at the Finance Board, they cannot approve it. That is one way of moving along.

I would also say, in terms of overall housing needs, the use of the Community Investment Program to stimulate construction, particularly in tandem with HUD section 8 subsidies, I think is an exciting area that can be explored.

The New York Bank and Seattle Bank, on behalf of the President's Conference, are looking at ways to work with the FHA Insurance Program to stimulate multifamily construction in New York. We are going to do it probably with the State Housing Finance Agency.

Seattle is looking—I believe, Mr. Faulstich, you may want to comment on it—to doing it in partnership with one of his members. There is potential we would like to move forward on.

With regards to the first question, CRA reforms, I believe whatever is done, increased flexibility will be the key.

As Jim Faulstich mentioned, this is a very diverse nation. One size does not fit all. To the extent that whatever the rules for CRA happen to be, if they are too narrow, if they are too specific, then I think it limits the creativity, innovation of members to identify what their community needs to try to address those needs. Whatever it is, they need to recognize a broad range of activity our member institutions engage in and give them the recognition and credit, if you will, for the efforts that they undertake.

With respect to opening the housing spigots, I think it is important to remember that we are wholesale banks, and that I think the most effective way to use the home loan banks is through our customers, not only through our members but also through nonmember borrowers like the housing finance agencies that have the expertise to make this very specialized type of lending possible.

We are very excited in New England about the potential for lending to our housing finance agencies to help supplement their tax-exempt bond activities, and we have been told that access to the advances window is a very competitive alternative for them in lieu of a taxable bond program.

Chairman FLAKE. Mr. Schultz.

Mr. SCHULTZ. Mr. Chairman, certainly the Federal home loan banks cannot make up for income that is not present on the part of others, beyond the grants and advances under the Affordable Housing Program, and the suggestion Mr. DelliBovi has made with respect to that program is being examined in our bank at this time.

But, in general, we have continually believed that it is better to provide positive incentives for conduct than negative. The concept that you have put on the table of deposit insurance credits related to the type of lending one would like to see or some other positive incentive strikes us as a very positive way to bring about desired behavior.

In addition to that—or rather as an example of that, one way with respect to SAIF-insured institutions would be to change the law for the calculation of the shortfall so that CIP advances were not counted as advances to SAIF-insured institutions for the purpose of calculation of the shortfall. That will certainly stimulate, in many cases, increased CIP advances to SAIF-insured institutions.

Chairman FLAKE. Thank you.

Mr. Faulstich.

Mr. FAULSTICH. Mr. Chairman, I think we all could agree our CIP [Community Investment Program], our AHP [Affordable Housing Program] are very excellent programs. Unfortunately, only about one-third of our customers take advantage of those programs.

I have commented in writing with the banking regulators and visited them. They seem to be encouraged by this approach—that is, to give specific recognition, CRA recognition, to those banking institutions that do use those programs.

I think it would be a simple thing to do, would not involve a lot of hassle one way or the other, yet would be very positive in bringing to the attention and keeping the attention of our customers that, yes, these are good things to do. Let's get on with it, let's participate in the Federal home loan bank programs. I would hope that perhaps this subcommittee or the Banking Committee might want to consider that as a possible help to the CRA reform effort.

Chairman FLAKE. I think it would be very helpful.

I think, as a matter of fact, since we are not doing it legislatively, perhaps this subcommittee can speak with the regulatory bodies to assure that they at least consider this as part of their changes. Because I think it is important if those institutions are willing to participate, to take the risk, that they at least get credit for it.

I think Mr. DelliBovi knows in New Jersey you have Roxbury. I think all of you can identify the communities that you know can qualify. If they come under one of those programs, it seems to me to be reasonable that they ought to receive appropriate credit for it.

Mr. FAULSTICH. That would be a tremendous benefit to our communities, to our neighborhoods, to our customers, to our banks, if that were done.

On the other hand, I am very excited by the new authority HUD has to pilot a program, where they take the vouchers that would otherwise go to folks living in public housing projects and use that for home ownership. They have that authority now and are beginning to experiment with it.

We are working with a builder in Portland who is going to produce housing that would match those needs.

Coupled with that, of course, would be a good home ownership counseling program so we can develop that. But I am absolutely convinced, because I have seen it, where we have—well, our customers have taken homeless people and put them into houses that they own, with appropriate counseling. They have become tremendously successful homeowners, contributors to their community, tax-paying citizens. It can be done, given the right incentives and given the right program structure.

Chairman FLAKE. I think we also need some redefinition as it relates to what qualifies for CRA.

We know the old communities. I was up with Mr. Hinchey in Newburgh. He was telling me about the problems, but until I went there I would have thought of Newburgh as I do most properties up in that part of New York as good, strong, stable, solid, economically viable communities—until I had a chance to go.

I think somebody talked about the changes that have taken place since 1932. The reality is a lot of communities have changed so dramatically we need to look at how we qualify them in terms of our overall lending practices. I am sure you all have some in the areas you serve.

Let me again thank you for coming.

Wait a minute. I have to recognize everybody else. Am I the only one who raised questions to this panel?

Mr. ROTH. I think so.

Chairman FLAKE. I am. That is unfair.

Mr. Roth. I recognize you at this time.

Mr. ROTH. I will be very brief.

Mr. DelliBovi, are you the same DelliBovi that worked with HUD?

Mr. DELLIBOVI. Yes.

Mr. ROTH. I just have a quick question. I see Mr. Champagne——

Mr. DELLIBOVI. I cannot plead the fifth amendment on that.

Mr. ROTH. Mr. Champagne talked about flexibility. We know in modern business, in industry, everything is flexibility and, you know, downsizing.

I have a question about the Federal home loan bank. If we were going to downsize this more—Gore is talking about redefining government. Every time you go out and talk to people and say our government has gotten too big, our government costs too much, there is big applause from the taxpayers. If we downsized this, how would we go about doing that?

Mr. DELLIBOVI. The Home Loan Bank System?

Mr. ROTH. Yes.

Mr. DELLIBOVI. I think you have to keep in mind the System is owned by the stockholders. I think they have to make the decisions how they want to serve the communities. This is not a government enterprise. It is far more efficient than anything I saw at—when I was in the government. Let me just leave it there without getting in trouble.

Mr. ROTH. Everything in the government?

Mr. DELLIBOVI. I enjoyed my years of public service in the Federal Government, but I would not go back to my employees in the private sector and hold up any one of those agencies as a model of efficiency to be emulated.

I think the home loan banks are tight structures. They are run by boards of directors that are dominated by the private sector. We are very bottom-line oriented.

I think the real issue to look at is in terms of serving communities. If you had a more centralized structure, would you get the same level of service?

The chairman made note of the fact I rearranged my schedule to be here today. I was supposed to be up in Latham, New York, a small community outside of Albany. I will be there. I don't know if I were, you know, running a GSE for the whole country or half the country, that I would get to Latham. I have been to Beacon, to Newburgh, to Binghamton with Mr. Hinchey, out to Queens any number of times with Mr. Flake. We have been in communities all over New Jersey. I don't know why the top management would get into those crannies of America, those places where there is financial need if it were centralized.

I think the boards of directors have to make that decision in terms of the efficiencies they want, if they want to look at efficiencies. There may be some efficiencies that in terms of the dollars that can be obtained, although I would point out that we are a pretty thin operation.

All 12 banks, the operating costs I believe is about $200 million out of assets that we manage that are considerable. Our margins are very thin. Our overhead is very thin. If we continue to do the kind of technical outreach and be close to the communities, the heartland, my guess is that we do not want to be too centralized in either money center areas or in our Nation's capital or any place.

It is interesting, the System does not directly parallel the Federal Reserve System. When the New York bank was originally organized, it was the Federal Home Loan Bank of Newark. It subsequently moved to New York, which stayed close to New Jersey. There is a certain value for community bankers to be close to their wholesale correspondent bank.

Mr. ROTH. It is 12, Mr. Chairman. I think I will put my other questions in writing.

Chairman FLAKE. Mr. Hinchey.

Mr. HINCHEY. Thank you, Mr. Chairman.

I want to apologize for not being here at the beginning of the proceedings and to express my appreciation to Mr. DelliBovi, who has been very responsive to the needs of the people in the district that I represent in New York, I think to the needs of New York generally.

I think that it is an extraordinarily responsible and responsive institution that I think is working very well. That has been my experience in the short 17 months I have been a Member of the Congress working directly with the Federal Home Loan Bank of New York. They have done, in my view, a very good job. I want to express my appreciation to them.

Thank you very much.

Chairman FLAKE. Thank very much.

Mr. Baker.

Mr. BAKER. Mr. Chairman, I have a couple of questions of this panel. I will also try to be brief.

Mr. DelliBovi, in your statement that was prepared, you have already expressed through that statement support for the concept of the 30 to 40 percent increase in lending cap. I just wanted to interject that formally into the record. I really do not have a question for you. I want to express my appreciation for that position of the bank.

Mr. Champagne, your remarks were—I couldn't say any more about your support of that increase. I appreciate that.

Mr. Faulstich, in looking at membership of district banks, it appears to me that with the statement of Mr. DelliBovi of New York where the membership is skewed to risk rather than banks, virtually everyone else with one exception is either at 50–50 or—percentage of thrift bank membership. Seattle—this is yearend numbers—61–44 banks versus thrifts. That is probably outdated because I understand you have been aggressive in your marketing of new members.

Have you taken a position with regard to the 30 to 40 increase?

Mr. FAULSTICH. We discussed it, Congressman Baker, at our board of directors level. It is a vexing issue.

There is not a director of our bank that does not support total equalization of membership requirements for all customers of the bank. That includes voluntary membership.

Once you get into that area, then the Treasury Department comes in and says you cannot have all voluntary until you figure out the capitalization requirements because you have to have permanent capital. By the time you get to that question, you are into comprehensive legislation. It is a tough issue.

The one thing that I think has not been brought out, except perhaps by Mr. Schultz in his testimony, is that there is a real valuable purpose served in having credit available to our customers, whether or not it is extended to our customers. The fact we have only 10 percent extended currently to commercial banks, we probably have committed 30 percent of our total advances right now to commercial banks, which, if exercised, would be at that limit under current law.

Mr. BAKER. That is my point. Whether or not you have been able to take a public position on the Baker amendment as proposed, your membership today is in excess of 50 percent commercial banks. If banks borrowed and got advances at the same rate as thrift members operationally, you would have a difficult problem in telling commercial banks you are no longer eligible for advances because the law prohibits us from extending credit in excess of 30 percent to non-QTL members. Operationally, there would be a problem?

Mr. FAULSTICH. More than operationally. I think there would be a psychological deterrent to having banks participate in the Federal Home Loan Bank System if you ever had that.

Mr. BAKER. If we do not bring in new members to the System, advances don't increase, RefCorp obligations, affordable housing obligations remain in place, then the residual safe members become the water carriers for those obligations with earnings declining and members not getting dividends. Extraordinary.

Which gets me to your statement, Mr. Schultz. I want to make sure I understand the principal objection to the 30 to 40. Is it that in its concept, it is flawed? Or is it principally if we do the 30 to 40, then we perhaps might not take other steps which are needed at this time? For example, the reconstruction of the RefCorp obligation? Is that really the basis on which your opposition is stated?

Mr. SCHULTZ. Congressman Baker, our opposition is based on the fact that increasing the non-QTL limit to 40 percent from 30 is one of a number of things that should happen at the same time.

We believe that the allocation of the RefCorp shortfall is the principal deterrent to our recruiting commercial banks in San Francisco. We believe that that, together with clarification of the other membership rights and ownership rights in Federal home loan bank stock, would be appropriately addressed simultaneously.

Mr. BAKER. You understand the Baker-Neal original proposal vigorously attacked the RefCorp concerns and that as the proponent of modernization of the System by virtue of that legislation, I am certainly committed, in the long haul, to a systematic reform beyond the 30 to 40; but at the moment, the 30 to 40 appears to be the only element that we can move toward; and with virtually every other bank system finding its membership in imbalance as between banks and thrifts, that it is illogical for the System benefit not to move forward with 30 to 40 who because in its economic perspective it is based on sound principles? We want to make more advances so the Bank System makes more money. It has not been your correspondence but the correspondence of some of the members of the Bank System have missed that mark.

I wanted to take that opportunity, Mr. Chairman, to relay in this manner that I am certainly willing to work toward the overall construction of a system that makes economic sense for all members; but the opposition at this moment by the San Francisco bank to that issue makes resolution of those other complicating issues down the road even more difficult.

I do thank you for your support or your statement in principle to the idea of some resolution of the matter.

Thank you.

Thank you, Mr. Chairman.

Chairman FLAKE. Are you asking him to reconsider and revisit this issue?

Mr. BAKER. No, Mr. Chairman. I hope you do that.

Chairman FLAKE. Thank you very much.

The four of you have been excellent in your testimony. I think it helps us to move this process forward. Mr. Baker and I will be working on direct legislative matters.

I think your support of most of what has been proposed by HUD is helpful to us in terms of ultimately coming up with whatever we must do legislatively to make this whole process work in your best interests, and by so doing, make it work in the best interests of those communities we are trying to serve. I think we all have the same interests at heart; and hopefully, we can continue to move in that direction.

Again, I thank you so much. I realize that those of you from the West have come a long distance. I certainly appreciate that.

From Boston, from New York, certainly I am grateful for—we share more often, but certainly grateful for you coming this morning to share with us.

Thank you very much.

We have one final panel: Mr. Michael T. Crowley, chairman of the Federal Home Loan Bank Stockholder Study Committee; and Mr. David Holland, chairman, president, and CEO of the Boston Federal Savings Bank.

As we have done previously, you may feel free to summarize your statement and submit your entire written statement for the record. If you require more time, you may take as much time to explain what is in your testimony.

By unanimous consent, we will do that.

Mr. Crowley, we will begin with you. At this time, it is probable that we will—no. There is no red light on. It is possible we will go into session in the next few minutes. We will try to move this panel to a 15-minute timeframe if we can.

STATEMENT OF MICHAEL T. CROWLEY, CHAIRMAN, FEDERAL HOME LOAN BANK STOCKHOLDER STUDY COMMITTEE

Mr. CROWLEY. Thank you, Chairman Flake, members of the subcommittee, Mr. Baker. I am Mike Crowley, president and chief executive officer of Mutual Savings Bank of Milwaukee, Wisconsin, and serve as chairman of the Federal Home Loan Banks Stockholder Committee.

Of the five studies referred to by previous testimony, the original request from Congress of the study that we conducted provided a very unique and first-time—I might add—opportunity for the stockholders who own the System and have the private capital invested in the System to meet as a group and debate the structure of the System and try to arrive at a consensus regarding the future evolution of the System.

Although the System is not broke, as we heard many times today, we do think there is need for fix up; and although it doesn't have to be done on an emergency basis, we do think it has to be addressed.

I would like to briefly hit some highlights because of the late hour and I will then take questions.

First of all, the group did look at the mission of the System and in our report we outlined for your benefit what we view as the appropriate mission of the System. There has been talk today about having that put into the statute and further codifying that, the mission of the System. We agree there has to be attention paid to focusing on the updated 1990 and beyond version of what the System should be standing for and what it should be doing.

We also went on to point out that it is a System that functions on the wholesale level. It is a banker's bank. It is not a System making direct loans, contrary to the opinion of some people in the public. It does act as a wholesale institution.

Therefore, its real value is really supplying support to those member institutions that do the actual lending in the community, the institutions we heard examples about all morning who are out there in the communities working directly with the public and know their communities the best.

We see the System as whatever reform does take place continuing that role as being a supportive banker's bank in providing whatever Affordable Housing and Low-income Lending Programs through its members and not directly to the community itself.

We also looked at the position of the System vis-a-vis the other GSEs. One of the questions asked in the original mandate from Congress was whether the system should assume some specific targets such as Freddie and Fannie were given in the legislation that occurred.

We feel that because the System is the only GSE with a hard dollar commitment, $100 million a year of affordable housing funds that flow directly from the System to the communities, that the System is not to be further burdened with any specific targets or any certain allocations. That commitment I think speaks for itself, and thus the goals that have been established for the other GSEs are not relevant to the System.

Our positions on all of our issues were developed when Congress was in the very early stages of drafting the important community development financial institutions bill, H.R. 3474. We support the thrust of this legislation; and I would like to personally thank the Congress for including in that legislation a measure of regulatory relief which I know has been the topic of a lot of conversation on the part of bankers like myself.

We also support the targeted incentives that have been included in the Bank Enterprise Act title of this legislation. We applaud the willingness of the sponsors of this provision to consider innovative approaches.

The area of capital has been talked about in great detail. All I would like to say is we did study the capital issue. We know that there has to be a reordering of how the capital is functioning in the system.

We recommend that a minimum safety and soundness standard be established on a risk-based approach, similar in purpose to the stress tests developed for the other GSEs. Beyond that, from time to time, there might be a need for higher capital based upon the AAA rating of the system being maintained or the need to cover the RefCorp or the AHP obligations.

We do think there is a way to restructure the capital in an acceptable fashion. In that regard, the system has convened a capital study task force which will have its first meeting on June 2 and will try to complete its work by August of this year.

The task force will report back to the entire System and hopefully back to the Congress as to what its findings were. This might be the beginning of establishing some consensus on the issue of capital for the System.

The stockholders also feel because they provide the private capital which allows the System to function that they deserve a serious review of their role in the governance of the System. In fact, several of the studies, including the HUD study, have recommended a separation between governance and management.

Along those lines, we have not taken a position as to the three-pronged approach that HUD is recommending: The transfer of some authority to the Office of Federal Housing Enterprise Oversight; the program authority by HUD, and so on, but we are willing to look at the establishment of a strong safety and soundness regulator and, of course, the assurance that the main mission of the System is continued.

In the area of membership, we were unanimous in our recommendations about voluntary membership, equalized stock purchase, all the things you heard about all morning. The main part of my message as far as our deliberations was to quote directly from our text of the report.

We said, "The issues that are facing the bank system are significantly interrelated and cannot be addressed in isolation. We think it is so important to deal with the issues facing the system on a comprehensive approach so that all of the delicate balances can be maintained and that there not be an imbalance that is created by taking a piecemeal approach."

With that, I think I will conclude my brief remarks and ask you submit my entire written comments for the record.

[The prepared statement of Mr. Crowley can be found in the appendix.]

Chairman FLAKE. Thank you very much.

You indicated you have not taken a position. Will the study group—I heard Mr. Retsinas earlier. Will you be making recommendations to HUD? Will you be working cooperatively to come to agreements that everyone can basically live with?

Mr. CROWLEY. The study group, Congressman, is no longer in session or no longer in existence. It went out of existence when its report was delivered to the Congress.

The Federal Home Loan Bank System has convened a government affairs committee, which is made up of stockholders, public interest directors from the various bank boards and bank presidents. This group would be—along with, of course, the individual boards of directors—the appropriate forum to take this next step and get the consensus.

Chairman FLAKE. Thank you.

Mr. Holland.

STATEMENT OF DAVID F. HOLLAND, CHAIRMAN, PRESIDENT, AND CHIEF EXECUTIVE OFFICER, BOSTON FEDERAL SAVINGS BANK

Mr. HOLLAND. Good morning. Thank you very much, Chairman Flake, Congressman Hinchey, Congressman Roth.

It is my privilege to appear today to present the views of the Savings and Community Bankers of America. We are a national trade association representing community-based housing-oriented depository institutions.

I am David F. Holland, chairman and CEO of Boston Federal Savings Bank and chairman of SCBA. I also want to especially thank you for adding me to the hearing this morning and giving me the opportunity to testify here today.

I would like to emphasize I am appearing here strictly in my capacity as chairman with SCBA even though I currently serve as vice chairman of the Federal Home Loan Bank of Boston.

SCBA appreciates your timely call of an oversight hearing on the future of the Federal Home Loan Bank System. The Congress was wise to request a review of the progress of the System from a wide variety of perspectives in the five studies mandated by the Housing and Community Development Act of 1992.

It is also an item of utmost interest and concern to SCBA member institutions which can ultimately enjoy no better fortune than the communities which they serve. We have heard a lot of good testimony this morning from a variety of different individuals, but I think it is important to appreciate, and I am sure you do, that the stories told about lending done around the country are done by members of the Federal Home Loan Bank System. Most of those same institutions are members of SCBA. Most of the items recited have been done over the last several years.

The Federal Home Loan Bank System members have been doing this for 60 years plus, the member institutions have been doing it for, in many cases, over 100 years because we have been in the communities doing this kind of lending, supporting the communities for years and years.

In the limited time available, what I would like to do is submit my written testimony for the record and summarize very briefly and add perhaps emphasis to comments made this morning that I think are important, and perhaps in a couple of areas add a little value, and weigh in in areas where there is not 100 percent agreement, and of course, be available to answer any questions.

I think we will start with the main focus of the Federal Home Loan Bank System which within its overall mission should reflect the System's title; that is, home loans. We share the view that mortgage credit access is at best a necessary but not sufficient condition for neighborhood revitalization.

The existing statute contemplates the use of specially priced Community Investment Programs, CIP investment advances for both mortgage and broad scope to low- and moderate-income neighborhoods. As a practical matter, the restriction of collateral for advances to real estate mortgage product has not created a problem for System members.

The mix of regular lending normally provides an excess collateral pool. Those that are QTL qualifying, have at least 65 percent of their assets as qualifying collateral and those newer members that perhaps have a lower QTL are gradually expanding their pool of eligible collateral.

The major problem in advancing credit for community lending by any insured institution is the sometimes overly harsh scrutiny of safety and soundness examiners who criticize the very loans praised by the CRA compliance examiners.

Another important comment I don't believe has been focused on this morning is the targeting of limited financial and human capital resources is essential. This is the reason why SCBA joined with ACORN and other community groups in opposition to the quantum leap in the Federal Housing Administration's loan limits in H.R. 3838. Tight focus on the segment of the market in most need of Federal assistance and in partnership with community institutions in accessing both mortgage and business credit is essential.

I want to emphasize how proud we are of the achievements of the Bank System over the six decades and the priority we place on its primary role as a liquidity source for regulated depository institutions whose business strategies incorporate a major role for housing and community finance.

I just want to pause here again and expand slightly on comments made earlier.

Billions of dollars in mortgage and other lending are made available because of the lower liquid asset holdings made possible by the availability of the FHFB liquidity financing.

This allows member banks to provide more loans to communities that otherwise would have to be sitting in investments on our shelf to provide for liquidity needs we now have available to us from the Federal home loan bank. That is a very, very important dimension to the Federal Home Loan Bank System as well as its support to the member institutions to lend long term to the community, to homeowners, whether it be for homes or community development.

SCBA believes the role of the System in enabling stockholders members to meet the financing needs of their communities as portfolio lenders remains viable and important. We are encouraged that the administration, via the HUD Report, has expressed a similar view. The continued vitality of the traditional functions is the basis from which the system can expand prudently into new activities.

As the Congress considers how to proceed with reform, considerable comfort can be taken from the System's current health. The System is not in crisis.

It is certainly true, however, many of the assumptions implicit in the feasibility analysis for the financial burdens placed on the system by FIRREA proved to be inaccurate. Although the last 5 years have put stress on the System and it has navigated through rougher waters than charted, the System has been able to cope with those problems.

Advance demand has been so buoyant some have foreseen a problem from a completely different direction. This is the argument the System is in urgent need of relief from limitation on advances to members that do not satisfy the complex QTL test. A provision lifting that limit from the 30 to 40 percent has been included in H.R. 3474 and has been discussed extensively this morning.

Again, I have extensive comments in my written report. Let me make a couple of points here.

First of all, I think we are kind of uniquely situated in my organization to comment because we have voluntary members, mandatory members, SAIF members, and BIF members. We represent a segment of the membership of the Federal home loan bank which holds 73 percent of the System's capital.

Although the numbers of members are weighted in favor of the commercial banks, the percentage of stock ownership is weighted in favor of the thrift membership, particularly the mandatory members. The other 27 percent of the stock is owned by commercial banks. Although they are the largest membership segment, these kind of statistics are used to support the case for relief from the 30 percent limit.

I think these numbers to a degree are misleading. First of all, the ceiling does not target commercial banks, just non-QTL members. A lot of the commercial banks qualify as QTL members and therefore do not come under that umbrella. Right now, the percentage of loans to non-QTL members is approximately 8 percent. Granted the economy is hopefully continuing to improve, and the demand for loans will increase. But even if it doubled unilaterally without any corresponding increase in the QTL members, the ratio would only jump to 16 percent.

I think we are quite a ways away from any crisis; and as Assistant Secretary Retsinas stated this morning, we do have a Rubik's cube here. I think the way Jim Faulstich described the interrelationship between the membership, the capital, all has to be considered in a comprehensive manner.

Let me just make two other points that I don't believe were made earlier.

That is, a mandatory member must maintain 65 percent QTL or not be able to borrow at all. Well, that is as equal an injustice as perhaps what the commercial banks potentially sometime down the road are going to experience if we bump up against that 30 percent limit.

SCBA and its members totally support the lifting of that 30 percent limit to 100 percent; but it should be part of comprehensive legislation when we get all members as voluntary members and when we get the restrictions lifted which are placed on QTL members not even being able to borrow a penny when they fall below 65 percent.

There are other areas that again I will refer you to my written testimony in the area of governance. Let me make just one comment there. As part of this comprehensive legislation package, governance should be delegated to the district banks to the extent possible. I applaud the Federal Housing Finance Board for taking leadership in that area.

In the area of membership, I believe all five studies commented unanimously the membership should be left essentially as it is currently configured. We support that position as well.

With regard to capital, that is a much more complex issue. I think an element of permanent capital is probably appropriate. As was, I believe, alluded to earlier this morning, there is a capital study being supported by the district Federal home loan banks. I think it is premature to make any judgments in that area except there probably is a need for some form of permanent capital.

When that permanent capital comes into place, there should also be some protection so there is no fear of confiscation of that capital in the future as was done under FIRREA. I think perhaps a rebuilding of a portion of the retained earnings would be a positive component here of that permanent capital as well as maybe some different forms of capital; but the protection against the fear of confiscation I think is something that should be considered by Congress.

One other comment with regard to the capital, that is that there has been some discussion about that capital being sold to the community at large. We think the capital perhaps ought to be tradeable but only among the qualifying membership.

We have seen what has happened with respect to some of the other GSEs that have had capital put into the stock market. We have kind of like a community cooperative effort. We think the kind of things you heard this morning that have been achieved have been assisted through that mechanism. It is important to keep that confinement in terms of any stock that is issued to be not to the public but to the members that currently qualify.

The Federal Home Loan Bank System, as has been stated this morning, is a wholesale lender. We think that that is important.

I think with that I will conclude my comments and leave opportunity for questions.

[The prepared statement of Mr. Holland can be found in the appendix.]

Chairman FLAKE. I thank both of you.

I want to recognize Mr. Roth who has to leave.

Just one quick question, Mr. Holland. You are supporting raising the limitation on advances beyond 30 percent to 100 percent?

Mr. HOLLAND. Only as part of a comprehensive package. In other words, there should be no limitations distinguishing between commercial banks or QTL members versus non-QTL members. There should be no—inconsistently, there should be no discrimination between voluntary and nonvoluntary membership. The extra commercial stock the commercial banks have to buy should not prevail in the future. There should be equalization of stock purchase requirements and borrowing opportunities for all.

Chairman FLAKE. OK. I just wanted that clear for the record.

Mr. Roth.

Mr. ROTH. I would like to ask Mike a question. You not only were part of the committee, you were chair of the stock law setting committee; right?

Mr. CROWLEY. Right.

Mr. ROTH. We are proud of the work you do here and also in Wisconsin.

The subcommittee recommended the capital—I am interested in this issue Mr. Holland brought up about capital. If I recall correctly, your committee recommended that the capital of the System mirror that of Fannie Mac and Freddie Mae?

Mr. CROWLEY. We didn't talk about specific percentages but alluded to the fact that the mechanism or the scheme under which Freddie Mac and Fannie Mae were structured would be similar; in other words, a minimum amount of capital based upon a risk-based component which would have a stress test attached to it.

In addition to that, there might be a minimum tangible level and the safety and soundness regulator in particular would have to have the ability from time to time to mandate a higher level if it were called for under conditions that existed.

We are awaiting the System capital study to get more into the focus of exactly how it would all work.

Mr. ROTH. This risk-based concept is one of your hallmarks, though; is that right?

Mr. CROWLEY. Yes, it is. By any measure of risk, the System, the Bank System is a very low-risk operation, as evidenced by the AAA rating it received. We feel to make it more efficient, we had to adjust the capital levels to reflect that, that low risk, so that we can have reasonable return on equity for the stockholders. At the same time, though, meeting all the obligations—and I underline—RefCorp and the AHP.

Mr. ROTH. OK. Thank you for your testimony, gentlemen.

Mr. Crowley, we appreciate the work you did as chairman of that committee.

Chairman FLAKE. One question. You heard the HUD testimony in terms of separation of powers with regulation going to the Federal Housing Enterprise Oversight Board, delegation of the housing mission to HUD, and governance would be retained by the banks. What is your general feeling having done your studies in terms of reform, in terms of these recommendations?

Mr. CROWLEY. First of all, I would like to say as part of this whole consideration of governance, this governance task force, the Government Affairs Committee of the Bank System met 2 weeks ago in session in Chicago and passed a resolution recommending to each one of the banks and their boards of directors that the administration be asked not to appoint any additional full-time Federal Finance Housing Board members until this thing gets sorted out. We do not think it is wise to restructure that until we know where it is headed.

Second, as far as the HUD study is concerned and the multiple tiering of regulatory process that it recommends, we know we want a strong safety and soundness regulator. We think that that is imperative to keep the credentials of the System impeccable and continue the flow of low-cost money through the System to its members and to the communities they serve. So the strong safety and soundness component is important.

We think that as far as a program management and oversight of a mission, if in fact the mission is put into statutory format, if in fact it is something that is clear and can be monitored in various ways, the jury is out on whether or not we need to have yet another layer of oversight in that regard.

It is conceivable a safety and soundness regulator could oversee it as the safety and soundness regulators oversee CRA right now. We do not have a special agency to examine our institutions for CRA. It is part of the safety and soundness role.

Chairman FLAKE. Mr. Holland.

Mr. HOLLAND. Yes. I think right now we have one body that does virtually all of those three functions in terms of governance, safety, soundness, and mission, in form of the Federal board. They have done a good job in their record to date.

However, it has been stated by virtually all the reports that there needs to be a separation between the governance and the regulators' function so that there is a clear distinction there. SCBA agrees.

I think the worst of all worlds would be to end up with three regulators replacing the current one. Some consideration of perhaps transferring like was suggested earlier the safety and soundness over to OFHEO has some merit that should be considered. I think thought has to be given to that.

Also, much of the authority of governance and management could be delegated down to the district banks, I think would be a positive step in that direction.

And there may be—because the banks are jointly and severally liable—a certain level of issues that might need to have the oversight of maybe some representation of the 12 district banks to kind of oversee the safety and soundness of the joint and severally liable issues. Not to replace the role of the safety and soundness regulators, but to act in their capacity and have that overseen to make sure they are acting in an appropriate manner.

With regard to the comments that Mr. Crowley made with regard to HUD and having a specific mission for the mission of the Federal home loan banks, I would concur with his comments in that regard.

Chairman FLAKE. It is interesting, isn't it, that we are talking about the possibility of having one super regulator merging OTS and OCC and Fed and FDIC. Here we talk about splitting it. It is interesting. So it should be interesting to see how this plays out.

Mr. Hinchey.

Mr. HINCHEY. Mr. Chairman, I have a broader philosophical question I would like to pose to you.

The Federal home loan bank was created during a time of economic distress in the country. It is a creature of the Depression. It was created in order to try to make it possible for people to afford to buy homes who would not otherwise be able to do so. In that regard, I think it has been extraordinarily successful over the years. It has been a very sound institution. Its 60-odd-year history has been one of security, safety, soundness, in a very exemplary way.

Nevertheless, at this point, we find ourselves in a situation where an increasing number of people seem to be frozen out of the housing market. That population is growing.

Also, Mr. Holland, in your statement, you made the observation that communities are made up of more than just houses. They are, after all, commercial establishments, other institutions that exist within those communities.

I wonder to what extent thought has been given to what we need to do, what the Congress ought to be doing, in the reauthorization and in trying to move forward to provide opportunities for those people who are left behind and those communities that are left behind by a System that was fashioned to meet the needs of 1932, when in 1994 we have additional problems that go beyond those that existed in 1932?

Mr. CROWLEY. To start off, I think there is definitely no comparison between 1932 and 1994. The simple answer in 1932 was for my institution to make a single loan to some family that perhaps could not buy a house or was about to lose their home because of other conditions. For the most part, they had the economic, cultural, and social background for home ownership through their family upbringing, whatever.

In 1994, in the city of Milwaukee, we have a very serious situation. We have the unfortunate situation of being very economically segregated. We have, along with that, a host of social issues which I am sure Congressman Flake has viewed in other parts of the country in his work in his own community, his own congregation.

We have to work on this through the Bank System and through its members with the Congress in a multiple-tiered approach. It is not simply saying let's get more long-term fixed-rate money, and we will have a bunch of homeowners that have not been able to do it up till now. We have the low-income housing tax credits; we have the downpayment; we have the home ownership counseling component; we have the default counseling component, the PMI companies, the secondary market component.

Is it impossible? No, it is not. A lot of this is coming together as I sit here and speak to you today. But the way we attack the problem just as the way we build cars and houses is so different from 1932. I think we are up to the task. I think we can accomplish something. I know in my community and in the areas around the country that I visit in other Federal home loan bank districts, they are doing something about it.

I would agree with your analysis. I would also say that I think as part of the comprehensive look at this System, I believe we can make it better and respond to these unique situations.

Mr. HOLLAND. I agree with everything Mr. Crowley said but also pick up on something Mr. Faulstich said earlier. That is providing the incentives. I think there is a natural inclination, as I said earlier, about the member banks doing their thing in their communities for over 100 years. That is not only continuing but expanding. There were examples after examples mentioned this morning of that kind of activity that takes place.

I think it is these partnerships that exist, and the Affordable Housing Program the Federal home loan bank offers that has been a tremendous—using a word that was used earlier this morning—"catalyst" in bringing the different levels of different organizations together, that has really been true in Boston and I think across the country an excellent vehicle to help deal with these issues you bring up.

Mr. HINCHEY. Thank you both very much for that.

I would just observe the obvious. That is, that the world is changing now even more dramatically than it was back in those days.

We have a system of securitization now which has changed the whole home-lending picture substantially within the last several years. I would be grateful to you if you have access to some thinking in this regard, the thinking being in the direction of attempting to expand homeowner opportunities and other investment opportunities to people who are currently frozen out of those markets. If there are economists within your institutions or others who are thinking about these things, a way that makes sense to you, I would appreciate learning more about it.

Mr. HOLLAND. We will try to provide you with the information that we have. Be glad to do that.

Chairman FLAKE. Let me close by thanking you all for coming, and Mr. Crowley just suggested that even as we note that there was a difference between 1932 and 1994, that some of the economic, social, cultural definitions have to be expanded for an inclusiveness that was not part of the initial thinking. That is not for ethnic groups but even with the immigration status and other issues that have to become part of what has to be that analysis. Even our understanding of practices of lending along sexist and the practice of misogyny as it relates to overall lending practices to women.

I think our overall cultural and social ideas have to be advanced to meet an age of change where people who could not afford previously, by some limited definitions of what their social and cultural abilities were, have to be included into the mix of variables that are put in place now.

I think if we can become broad enough to look at that and be creative enough—I would look at Mr. Schultz sitting back there, in places like San Francisco. Who would have thought you had to analyze sex issues based on the kind of population you serve in San Francisco, that in 1932 you would not have even put into as a factor. There are a lot of new variables. I think the key to this industry serving the whole of society will become trying to analyze as many variables as possible.

Thank you all for coming.

Thank you for your patience, your support, your willingness to participate. It has been extremely rewarding for us on the subcommittee; and we will try to move forward in assuring what you have shared with us is shared with the subcommittee as a whole and we can do legislation to resolve many of these issues that are before us.

Thank you very much.

This concludes this subcommittee hearing.

[Whereupon, at 12:41 p.m., the hearing was adjourned.]

APPENDIX

May 24, 1994

STATEMENT BEFORE THE HOUSE COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS SUBCOMMITTEE ON GENERAL OVERSIGHT, INVESTIGATIONS, AND THE RESOLUTION OF FAILED FINANCIAL INSTITUTIONS

WASHINGTON, DC
MAY 24, 1994

BY
NICOLAS P. RETSINAS
ASSISTANT SECRETARY
FOR HOUSING-FEDERAL HOUSING COMMISSIONER

Thank you Chairman Flake and Members of the Subcommittee for inviting me to testify this morning on the Department of Housing and Urban Development's (HUD's) recently released study of the Federal Home Loan Bank System. I am here not only in my capacity as Assistant Secretary of HUD, but also as Secretary Cisneros's designated representative on the Federal Housing Finance Board (Housing Finance Board). Larry Costiglio, who serves with me as a director on the Housing Finance Board, is with me this morning and is also available to respond to your questions.

The Housing Finance Board is the safety and soundness regulator of the Federal Home Loan Bank System, and ensures that the System fulfills its public policy role as a primary source of funding for housing finance and also carries out its statutorily mandated Affordable Housing Program and Community Investment Program.

As you know, the Housing and Community Development Act of 1992 required the Department of Housing and Urban Development to study 14 specific questions regarding the Federal Home Loan Bank System and to submit a report containing any recommendations for legislative action to the congressional banking committees. The Act also required reports on the same 14 topics from the General Accounting Office, the Housing Finance Board, the Congressional Budget Office and a committee representing members of the 12 Federal Home Loan Banks. The HUD report reflects our effort to form a consensus through a cooperative, consultative process within the Administration. We believe it will pay dividends later as we work with the

Treasury Department and others in the Administration to develop a comprehensive legislative proposal to modernize the Federal Home Loan Bank System.

While HUD's report provides answers to all 14 questions, today I would like to focus on the five most important topics raised by the study -- 1) Mission, 2) Capital Structure, 3) Membership, 4) The Effects of the Financial Obligations Placed on the Federal Home Loan Bank System by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989; and 5) Governance and Regulation.

MISSION

The Federal Home Loan Bank System was created in 1932 in response to the nation's need for a secure, dependable source of housing finance lending. To date, the System has remained safe and sound -- never once suffering a credit loss in its 62-year history. That is a message worth noting. The Federal Home Loan Bank System is not broken, nor is it facing apocalypse. But we need to examine how it is positioned going forward, and the studies have provided this opportunity.

It is also important to note that the Federal Home Loan Bank System operates in a very different market environment today than it did 60 years ago, or for that matter, 5 years ago. The "wholesale" housing finance market has changed significantly in the past few decades as securitization has come to be the predominant financing mechanism, involving Ginnie Mae, Fannie Mae, Freddie Mac and private conduits. The securitization process gives retail lenders a source of liquidity in exchange for their mortgages, enabling them to originate additional mortgages.

But despite the tremendous growth of the secondary market, the Federal Home Loan Bank System, through its 4600 member financial institutions, continues to serve an important support role for community-based lenders involved in the primary mortgage market. That is, Federal Home Loan Bank System advances (loans) make it more feasible for lenders to originate and hold loans that do not conform to secondary market underwriting standards but are nonetheless responsive to local needs and conditions. A Federal Home Loan Bank does this by accepting a member's pledge of home mortgages, other real estate-related collateral, or Government securities in return for an advance. It is this support of "portfolio lending" and the System's unique role in support of community-based lenders that sets the Federal Home Loan Bank System apart from the other wholesale sources of housing finance. At the outset of our study of the Federal Home Loan Bank System it was important to recognize this.

This led us to consider constructive change to enhance the underlying strength of the System and to ensure that it satisfies its mission. First, it is necessary to reaffirm and codify the public purpose of the Federal Home Loan Bank System -- that the Federal Home Loan Banks should continue to specialize in collateralized advances to portfolio lenders. Further, we recommend that the System's mission statement include support for community development lending, multifamily lending and lending for low- and moderate-income housing consistent with safe and sound operating practices. While the HUD report does not make any prescriptions or requirements for engaging in community development lending, we believe the strength of the System is in the potential of its community-based members. The Federal Home Loan Bank System, through its community-based members, is uniquely situated to affect and influence community lending.

With the essential purpose of the Federal Home Loan Bank System defined, we then sought to determine whether the System was making full use of its potential in terms of its public purpose. We believe that while it is important that the Federal Home Loan Bank System assist community lenders, we should be able to demonstrate that the Federal Home Loan Bank System facilitates community lending.

The Federal Home Loan Banks' most visible initiatives in the area of community lending to date have been the Affordable Housing Program (AHP) and the Community Investment Program (CIP). The AHP is often cited as a national model of a successful housing program, having subsidized 63,000 units with $237.4 million in subsidies leveraging $3.3 billion in development costs. CIP advances are made to member institutions at the FHLBank's cost of funds plus administrative expenses. Since 1989, the CIP has experienced dramatic growth, having financed $4.5 billion in community development loans including

$150 million for economic development projects. These are relatively new programs that are already achieving success and show promise for the future.

The HUD report recommends that the objectives of these programs be extended more generally to the overall advances program to further expand lending for housing for low- and moderate-income families, multifamily lending and community development lending. An appropriate definition of community development lending for this purpose is loans that serve: 1) investment areas that meet objective distress criteria, or are located in designated empowerment zones or enterprise communities; or 2) targeted populations identified as being underserved by existing financial institutions, whose purpose is to develop or support:

- Commercial facilities that enhance revitalization, community stability, or job creation and retention efforts in targeted areas.
- Business creation and expansion efforts that create or retain jobs for low-income people, enhance the availability of products and services to low-income people, or create or retain businesses owned by low-income people or residents of a targeted area.
- Community facilities that provide benefits to low-income people or enhance community stability.
- Home ownership opportunities that are affordable to low-income households.

- Rental housing that is principally affordable to low-income households.
- Activities of community development loan funds that support any of the above purposes.

To control operational costs to the Federal Home Loan Banks from nonresidential lending, eligible non-real estate community development loans should be supported by Federal Home Loan Banks in the same manner in which such loans may be supported in CIP; that is, they should count as authorized uses of advances, but traditional forms of collateral would be required to be pledged against the advances. It is not recommended that the categories of loans eligible to be pledged as collateral be altered. Consistent with this emphasis on controlling the risks that may accompany broadened programs, the 30-percent limit on use of other real estate-related collateral should be retained.

Our report also identifies several new initiatives for the Federal Home Loan Bank System to support multifamily lending within the scope of their existing lending authority. Already some innovative projects are using equity financing from AHP and debt financing from CIP.

For example, the Federal Home Loan Banks could serve as a clearinghouse to facilitate the sale of multifamily mortgages from one member to another. By facilitating the transfer of associated risks among members, the Federal Home Loan Banks could help increase the capital invested in multifamily housing development. In addition, the multifamily risk-sharing demonstration program authorized under section 542(b) of the Housing and Community Development Act of 1992 offers new possibilities for the Housing Finance Board, the Federal Home Loan Banks and their member institutions to expand activities in the multifamily field. The demonstrations under this section are to involve partnerships, reinsurance, risk-sharing agreements, and other types of formal relationships between the Federal Housing Administration (FHA) and other organizations such as the Federal Home Loan Bank System, Fannie Mae, Freddie Mac, and other qualified financial institutions. In this case, risk would be shared between FHA and depository institution members of the Federal Home Loan Bank System, with coordination through the Federal Home Loan Banks and the Housing Finance Board. Like community lending, expanded support for multifamily lending, should be accomplished while maintaining traditional forms of collateral to control risk.

CAPITAL STRUCTURE

As we look to the future of the Federal Home Loan Bank System, a core issue is the capital structure. Capital must provide the Federal Home Loan Banks with a financial cushion adequate to protect against the various risks in their operations. The HUD report agrees with the other studies that strongly suggest the need for a permanent capital base. Further, we believe that appropriate levels of regulatory capital should be determined using both risk-based and minimum capital standards.

Despite these issues, it should be made clear that the Federal Home Loan Bank System is not currently undercapitalized. In fact, the most recent study of housing GSEs' risk ratings by Standard & Poors gave the Federal Home Loan Bank System a AAA credit rating without any implicit Government backing.

Currently, the Federal Home Loan Banks raise capital by means of mandatory stock purchases by members, in accordance with statutory requirements. In addition, the Federal Home Loan Banks must comply with a 20-to-1 maximum debt-to-capital ratio and a maximum interest rate risk requirement established by the Housing Finance Board.

However, there are concerns that Federal Home Loan Bank System capital may be subject to what may be termed "membership risk", which is depletion of capital by members that can withdraw from the System and redeem their stock. This risk has been a factor since 1989, when the passage of the Financial Institutions Reform, Recovery and Enforcement Act (FIRREA) provided membership for commercial banks and credit unions for the first time in the Federal Home Loan Bank System's history. These new members of the System can opt to voluntarily withdraw their membership and redeem their investment at par value. Prior to FIRREA, state-chartered savings banks and insurance companies were the only voluntary members. The growth in voluntary membership since FIRREA has steadily increased. At the end of 1989 voluntary members represented 8.8 percent of total System membership and accounted for 8.5 percent of total System capital. As of March 31, 1994, voluntary members represent 65 percent of total Federal Home Loan Bank System members and account for 36 percent of total Federal Home Loan Bank System capital. The upward trend in voluntary membership continues as the Federal Home Loan Bank System is now adding approximately 100 voluntary members a month -- up from a monthly average of 75 in 1993. Membership risk will increase further in 1995 when State-chartered savings associations become voluntary members.

The HUD report discusses several alternative approaches for creating permanent capital to protect against financial risks. The report notes that the issuance of non-refundable, tradeable stock could improve the System's protection against financial risks, including membership risk, at a lower capitalization than at present. To preserve the System's cooperative management structure, voting rights could accompany stock whose ownership is restricted to members. Issuance of certain financial instruments to private shareholders (i.e., other classes of common stock, preferred stock, or subordinated debt), or requiring that members that increase their use of advances purchase additional stock, could enable the Federal Home Loan Banks to increase and decrease capital cyclically with changes in advances. In any case, marketing of securities to the public would be viable only if the System is expected to be sufficiently profitable.

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The report also notes that the Federal Home Loan Bank System could be required to build permanent capital through retained earnings. Capital structures that combine elements of these two approaches may be possible.

The Treasury Department is developing the Administration's proposal for restructuring System capital. HUD will work with the Treasury Department as options are developed. As indicated in our report, we expect that any capital restructuring proposal for the System will include risk-based capital and minimum capital requirements.

MEMBERSHIP

The Federal Home Loan Bank System thrives on its ability to attract and retain capital. Evidence of this ability is the nearly 2500 new voluntary members (commercial banks and credit unions) that have joined the System since 1989. We are confident in the fact that the System offers value to its members. In that spirit, and in the interest of fairness, the HUD report recommends that membership be voluntary for all Federal Home Loan Bank System members regardless of charter. It is important to note that HUD conditions its endorsement of voluntary membership on the establishment of permanent capital and risk-based capital standards for the System that ensures the System can handle the additional risks of voluntary membership while maintaining its capacity to meet its ongoing obligations. Specifically, HUD is committed to ensuring that the AHP and Resolution Funding Corporation (REFCORP) obligations are not undermined as the System moves toward fully voluntary membership.

Another membership issue involves the Qualified Thrift Lender (QTL) status of the System's members. To obtain advances, a savings association must meet the QTL requirement, which requires them to have mortgage-related assets equal to 65 percent of total assets. Also, Federal Home Loan Bank advances to non-QTL members -- mostly commercial banks -- are limited to 30 percent of aggregate System-wide advances. HUD believes the QTL test and the 30 percent limit should be eliminated as a condition of access to advances. The cap on System-wide advances to non-QTL members is an unnecessary potential deterrent to voluntary membership and may in the future constrain overall System support for housing finance and community development. It should be noted that the percentage of home mortgage loans held in portfolio by commercial bank members of the Federal Home Loan Bank System grew at an annual rate of 22 percent during 1992 and 1993, while non-member commercial banks increased their holdings of home mortgage loans at an annual rate of only 4 percent over the same period.

HUD's research indicates that a degree of concentration in mortgage-related assets (if properly managed) can be an effective profit-making strategy for a local portfolio lender. Thus there remains an incentive for depository institutions to continue to specialize in mortgage lending, even if QTL rules governing advances are relaxed. In addition, the orientation of FHLBank members toward mortgage finance would be maintained through restrictions on collateral and use of advances.

Commercial banks and credit unions that do not qualify as QTLs face disincentives to borrow advances once they are Federal Home Loan Bank members since stock purchase requirements for non-QTLs are more costly than for QTL members.

We believe that equalizing the stock purchase requirements for all Federal Home Loan Bank members and removing the QTL test as a condition for access to advances will assist the Federal Home Loan Banks in fully realizing their potential in housing finance and community development lending.

Furthermore, HUD supports the current requirement that institutions must have at least 10 percent of their assets in residential mortgage loans to be eligible for Federal Home Loan Bank membership. But our recommendation goes further to recommend that, in keeping with the System's portfolio lending role, only whole loans (not mortgage-backed securities) be counted toward this requirement.

EFFECTS OF FIRREA ON FEDERAL HOME LOAN BANK SYSTEM

FIRREA placed several financial obligations on the Federal Home Loan Bank System. First, $2.5 billion in Federal Home Loan Bank System retained earnings were used to defease the principle of the REFCORP bonds -- a funding mechanism for the Resolution Trust Corporation.

Second, the Federal Home Loan Bank System was required to contribute $300 million annually to help pay the interest on debt securities issued by REFCORP. Up to 20 percent of each Federal Home Loan Bank's annual earnings are allocated for REFCORP. If, after this initial 20 percent allocation, the total does not meet $300 million, the shortfall is apportioned according to each Federal Home Loan Bank's share of the preceding year's advances to SAIF-insured members. It is important to note that, to date, the 20 percent allocation has not satisfied the total REFCORP obligation in any year, with the total obligation representing 34 percent of System earnings in 1993. In addition, there is a legislatively mandated contribution to the AHP which began at 5 percent of annual net income (with a minimum of $50 million), and increases to 10 percent of annual net income (with a minimum of $100 million) by 1995 and thereafter.

The REFCORP payments represent a statutory assessment on the Federal Home Loan Bank System and its member institutions which will continue until the year 2030. The AHP obligation will continue in perpetuity.

The annual REFCORP assessment of $300 million was identified in 1989 as a fair share assessment on the Federal Home Loan Banks based on System earnings of $1.5 billion in that year -- significantly higher than current earnings. This burden, in our view, should be reduced. However, due to Federal budgetary procedures, this Federal Home Loan Bank System annual obligation cannot be reduced without finding another available revenue source to make up the shortfall. The prospects for this seem unlikely, but we continue to explore and discuss any and all suggestions for resolving the REFCORP problem.

GOVERNANCE AND REGULATION

When FIRREA created the Housing Finance Board, the four following co-equal objectives were established for its operation:

- o To supervise the Federal Home Loan Banks.
- o To ensure that the Federal Home Loan Banks carry out their housing finance mission.
- o To ensure that the Federal Home Loan Banks remain adequately capitalized and able to raise funds in the capital markets.
- o To ensure that the Federal Home Loan Banks operate in a safe and sound manner.

The Housing and Community Development Act of 1992 prioritized these objectives by designating the safety and soundness role as the Housing Finance Board's "primary duty." However, a structural problem exists by virtue of the fact that the Housing Finance Board also performs a coordinating and leadership role for the Federal Home Loan Bank System. This arrangement is contrary to the principle that the roles of regulator and regulatee should be administratively separated. The Housing Finance Board also recognized this potential conflict of interest in its report to Congress on the Federal Home Loan Bank System.

With regard to the Housing Finance Board's regulatory role, HUD recommends that the Office of Federal Housing Enterprise Oversight (OFHEO) become the financial safety and soundness regulator for the Federal Home Loan Bank System. While this is HUD's recommendation at this time, HUD may be willing to revisit this issue as the legislative process proceeds.

In addition, program regulation should be administratively separated from program management and coordination activities to ensure appropriate objectivity. Program regulation functions include administration of community support requirements, monitoring, reviewing any new program for consistency with the stated purpose of the Federal Home Loan Bank System, the appointment of the non-elected directors of each Federal Home Loan Bank, and oversight of rules such as those governing collateralization and use of advances. Program regulation should be assigned to the Secretary of HUD, who has this responsibility with respect to Fannie Mae and Freddie Mac. The program regulator would have to seek the approval of the safety and soundness regulator for any actions that could have a major financial impact on the System or any individual Federal Home Loan Bank.

HUD also believes that the current program management and coordination responsibilities of the Housing Finance Board constrain Federal Home Loan Bank business decisions, thereby limiting potential Federal Home Loan Bank System growth and its ability to provide maximum support for housing and community development. The Housing Finance Board is taking interim steps to determine within the current statute which of these non-regulatory roles do not require central coordination and may be delegated to the Federal Home Loan Banks themselves. However, to fully realize the System's potential, we suggest that the Federal Home Loan Banks should assume those non-regulatory roles currently performed by the Housing Finance Board, including the administration of the AHP and other strategic planning and central administration activities.

CONCLUSION

HUD is convinced that the Federal Home Loan Bank System is fiscally sound and its role in support of residential mortgage financing continues to be critically important today. Nearly all market trends suggest favorable growth prospects for the Federal Home Loan Bank System. After several years, the trend of declining advances appears to be reversing itself with average advances above $100 billion for the first quarter 1994, and up 25 percent over the first quarter of last year. As of March 31, 1994, total membership is 4,668 -- 1813 more members than at year-end 1990.

The AHP and CIP are well recognized as successful programs that encourage traditional financial institutions to increase their commitment to community lending. The Federal Home Loan Banks, through their Community Investment Officers and Affordable Housing Councils, are playing an ever increasing and important role in facilitating member institutions' compliance with the Community Reinvestment Act and its objectives by providing programmatic initiatives and technical assistance to their member institutions.

The HUD report seeks to build on the Federal Home Loan Bank System's strengths. We affirmatively state our continued belief that the support of portfolio mortgage lending should remain the core function of the Federal Home Loan Banks. However, this report outlines specific reforms needed to improve Federal Home Loan Bank support of mortgage lending for low- and moderate-income housing and to expand Federal Home Loan Bank support of lending for community development. Just as importantly, the report details several measures that are necessary to continue to strengthen the safety and soundness of the Federal Home Loan Bank System and refine its membership and governance structure.

All of our recommendations are interrelated and interwoven. We do not believe any singular recommendation should be undertaken on a piecemeal basis and that a comprehensive approach to Federal Home Loan Bank System modernization is required. HUD believes that with the completion of the five reports on the Federal Home Loan Bank System, this is the appropriate time to begin developing appropriate comprehensive legislation. It is my hope that today's hearing is yet another step toward that goal.

Again, thank you for calling this hearing today. Director Costiglio and I would be pleased to answer any questions you may have.

FEDERAL HOME LOAN BANK
OF NEW YORK

STATEMENT OF
ALFRED A. DELLIBOVI
PRESIDENT & CHIEF EXECUTIVE OFFICER
FEDERAL HOME LOAN BANK OF NEW YORK
BEFORE THE
SUBCOMMITTEE ON GENERAL OVERSIGHT, INVESTIGATIONS, AND THE RESOLUTION OF FAILED INSTITUTIONS OF THE COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

MAY 24, 1994

Good morning Chairman Flake. I'm Alfred DelliBovi, President of the Federal Home Loan Bank of New York. I appreciate this opportunity to comment on the HUD Study and possible legislation impacting the Federal Home Loan Bank System.

I believe the HUD Study is a solid, thoughtful report. It, as well as the reports of the CBO, GAO, FHFB and the Stockholders' Study Committee, should be thoroughly considered by Congress.

The New York Bank is in full agreement with the two central conclusions of the HUD Study: one, that portfolio lending in support of mortgage financing is critically important and, two, that support for mortgage portfolio lenders should remain the core function of the Home Loan Bank System.

For over three generations, the Home Loan Bank System has successfully served the public policy mission Congress has

One World Trade Center, Floor 103 New York NY 10048 • 212 912-4600 • Fax: 212 466-1327

given it through the efforts of our private sector members who own the System. Providing our members with financial incentives has helped ensure the economic well-being of the communities and the people served by these local lenders. Through our 265 community-based shareholders, the New York Bank plays a key role in hundreds of communities in our district which includes New Jersey, New York, Puerto Rico, and the U.S. Virgin Islands. Similar economic contributions are being made by the other eleven Home Loan Banks, with local, member lenders, in thousands of communities across the Nation.

The System works well and as the HUD Study tells us, it is not broken. But there are a few changes that will make it work better. Some will say that these changes should only be made as part of a comprehensive package. And we would likely support such a comprehensive legislative proposal. However, because the two-year HUD Study has just been completed, because the Department of Treasury, OFHEO, Fannie Mae, and Freddie Mac have yet to comment on the mandated studies, and because the key capital study is just getting underway, it is highly unlikely that a comprehensive proposal will be considered by Congress this session. While we look forward to working to develop comprehensive legislation in the future, we are in business today. And today we and local member lenders should enjoy the benefits of a few legislative changes that common sense dictates should be made.

To this end, the Board of Directors of the New York Home Loan Bank last week adopted a 1994 Home Loan Bank Legislative Agenda.

Specifically, the New York Bank's Board of Directors supports:

* Allowing the Home Loan Banks to incur daylight overdrafts under Federal Reserve Bank's daylight overdraft rules.

* Allowing members that opted out of the System in 1989 and 1990 a 3-month "window of opportunity" to rejoin.

* Stating in statute that all management duties reside with the district Bank boards.

* Allowing the two existing members of the Federal Housing Finance Board to constitute a quorum until the existing vacancies are filled or a comprehensive change in the Finance Board structure is enacted by Congress.

* The Baker Amendment contained in the Community Development Banking and Financial Institutions Bill passed by the House, and a proposal that would

calculate and apply a 40 percent non-QTL advance cap on an individual Bank basis.

* Amending Section 2901 of the Community Reinvestment Act of 1977 which would encourage and recognize for compliance purposes lending by institutions who help meet the credit needs of the local communities in which they are chartered, or in such targeted low- and moderate-income neighborhoods designated by the appropriate state authority consistent with the CRA.

We believe these changes can be made during this session of Congress. These changes will help guarantee the continued significant contributions of our Affordable Housing Program, our Community Investment Program, and our payment of REFCORP assessments. They will ensure that we are better able to conduct business and meet our mission; a mission, highlighted by the HUD Study, which is totally directed to supporting mortgage portfolio lenders.

During deliberations on these six specific points and other general issues of a comprehensive legislative package on the Home Loan System, it is critical to ask, if you will, the "fifteenth question" that the HCDA might have asked:
"How do portfolio lenders, with the support of the Home Loan Bank System, do their business?"

First and foremost, local lenders conduct their business with complete knowledge of and thorough commitment to their communities. Portfolio lenders are in business for the long haul and they are often located in the very heart of their communities. They are not merely temporary store front operations which only originate loans for housing units and close up shop if the market looks like it might turn.

No, the community lender is there to help finance a home for his or her neighbor. He or she is there to take deposits and offer savings accounts. And they are there to cash checks; to make car or personal loans; and, to keep valuables safe. In short, they serve to meet many of the diverse financial needs of their communities.

The ability to accept as collateral many types of mortgages has enabled the Home Loan Banks to offer a unique foundation, from which the local lender can play its key role in neighborhood building. With our flexible policies we can lend against a wide range of credit-worthy, mortgage-related collateral. This flexibility has, in turn, enabled portfolio lenders to meet their customers' varying financial needs.

A great many of our local member lenders hold in portfolio a mortgage on a one-to-four family residence with a small business -- such as a health care office, a dry goods store, or a restaurant -- that is attached to the home. These types of one-to-four family properties typically do not fall within the guidelines of the secondary mortgage market.

And we also accept non-conforming collateral, like the two family home with 21 boat slips in Suffolk County, New York or a bed and breakfast in Upstate New York.

Some of our portfolio lenders serve culturally diverse communities with different standards and practices for loan documentation. As a consequence, the mortgage documents do not conform to those of the secondary mortgage market, but do represent sound business.

Another significant area of support from the Home Loan Bank is for mixed-use multi-family properties. Let me just mention a few typical examples. In the Bronx, we accepted Oliver Gardens as collateral pledged for advances. Now this is a mixed-use building with forty-three co-op apartments, and like so many other buildings in New York City, with small businesses on the ground floor.

In Ulster County, New York, we have as collateral a property with a non-conforming blanket mortgage covering a three-story building with eight apartments, one family cottage, and two garage buildings with nine bays.

Similarly, in Orange County, New York, we have as collateral a five-unit apartment building with documentation that would not comply with the cookie cutter requirements of the secondary mortgage market.

This flexibility in the types of collateral we accept, allows the local lenders we serve in Puerto Rico to pledge 720 home loans originated under various housing programs sponsored by the Commonwealth.

But our community housing lenders don't make only unusual mortgages. The basic multi-family residential mortgage is a key part of the business strategy of many of the members in our District. Because of the special housing requirements of our metropolitan communities, our members have developed special expertise in multi-family lending. This is especially important in this sector of the residential mortgage market, because it is so clearly underserved by the secondary market. In fact, the multi-family mortgages that banks and thrifts hold in their portfolios total more than 3 1/2 times all multi-family mortgage securities outstanding. And the ability to pledge these mortgages at the Federal Home Loan Bank is a major factor in maintaining the flow of mortgage funding to this sector.

The traditional role of the banks in supporting homeownership through collateral lending was expanded by FIRREA through the Affordable Housing Program and the Community Investment

Program. The subsidies offered by these programs are important tools to portfolio lenders in their efforts to help revitalize neighborhoods, maintain property values and meet the credit needs of their communities.

Simply stated, the portfolio lender can count on the Home Loan Banks as a valuable and reliable source of funds to support mortgage lending operations. We serve as an important source of liquidity. A resource that enables a member to deploy a greater percentage of assets into mortgages or mortgage investments, thus increasing the availability of mortgage funds. Further, this access to ensured liquidity has been an important reason why over 2,500 community commercial banks have voluntarily joined the System.

The portfolio lender has relied on the Federal Home Loan Banks to serve as an integral partner for over sixty years. Through our programs, we ensure a flow of capital from Wall Street to Main Street. We are eager to work with you to help ensure that financing needs of all American homebuyers are met.

Thank you.

Federal Home Loan Bank of Boston

"New England's Housing Bank"

ORAL STATEMENT OF

GERARD J. CHAMPAGNE
EXECUTIVE VICE PRESIDENT

ON BEHALF OF

MICHAEL A. JESSEE
PRESIDENT

FEDERAL HOME LOAN BANK OF BOSTON

BEFORE THE SUBCOMMITTEE ON GENERAL OVERSIGHT, INVESTIGATIONS AND THE RESOLUTION OF FAILED FINANCIAL INSTITUTION

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

U.S. HOUSE OF REPRESENTATIVES

MAY 24, 1994

Mr. Chairman and Members of the Subcommittee, my name is Gerry Champagne I am Executive Vice President of the Federal Home Loan Bank of Boston. On behalf of the Bank's Chief Executive Officer, Mike Jessee, I am pleased to summarize his written statement concerning recently published studies on the Federal Home Loan Bank System. Unfortunately, Mike had a long standing commitment which could not be rescheduled and asked that I extent his apologies to the subcommittee for being unable to attend.

Mr. Chairman, we appreciate your interest in the Bank System, and express our sincere thanks to you for holding this hearing.

As mandated by the Housing and Community Development Act of 1992, the Federal Housing Finance Board, the GAO, the CBO, HUD and a group of System shareholders studied the FHLB System and submitted recommendations to Congress concerning the System's future structure and role.

With the release of the HUD study on April 25, all five studies have now been completed. What is perhaps most remarkable about the five reports is the degree of consensus and agreement on the major issues:

- First, the reports conclude that the System operates safely and soundly.

- Second, the studies find that the System fulfills a valuable purpose, by enhancing the ability of its members to hold residential mortgage assets in portfolio.

- Third, none of the studies recommend drastic reform. The recommendations contained in the five studies aim to enhance the System's ability to fulfill its housing finance mission. These enhancements include voluntary membership, equalizing the terms of access for all members, establishing a risk-based capital standard for the System, and vesting the corporate governance of the Banks in the Boards of Directors of each Bank--all of which the Boston Bank endorses.

As you know the Financial Institutions, Reform, Recovery and Enforcement Act of 1989 (FIRREA) permanently altered the nature of the Bank System.

First, the System was required to establish an Affordable Housing Program and a Community Investment Program to provide below-cost loans and grants for affordable housing and community development purposes.

The results of these two programs have been impressive. The AHP and CIP have helped produced 185,000 units of safe and decent housing for low-to-moderate income families throughout the U.S.

From 1990 through 1993, the System contributed more than $230 million to the AHP. These funds have been used to facilitate the purchase, construction, or rehabilitation of over 62,000 housing units.

64% have been targeted for very-low income households, - - households with incomes of less than 50% of the area median.

Through the CIP, the System has disbursed $4.5 billion in advances priced at its cost of funds, to be used by members for low- and moderate-income housing and economic development loans in distressed areas.

CIP advances have funded over 122,000 housing units and 136 economic and community development projects.

The second major change ushered in by FIRREA was an expansion of the Bank System's eligible membership base. Since 1989, commercial banks and credit unions, with a demonstrated commitment to housing finance, have been allowed to apply for membership.

There is perhaps no truer indication of the value of Bank System membership than what has subsequently occurred. Through March 31, 1994, 2,503 commercial banks and credit unions have elected to join the System. These new members have purchased $3.1 billion in System capital stock and have borrowed $16.6 billion from the 12 Banks.

Overall, these new commercial bank and credit union members make up 53.6% of all System members, own 27.1% of the System's capital and represent 16.8% of our lending activity. Commercial banks and credit unions continue to express interest in joining the System. As of March 31, 265 commercial banks and credit unions were in the application pipeline either at the 12 Banks or the Finance Board.

However, it is equally important not to overlook the Bank System's traditional membership base of savings and loans and savings banks. These are community lenders that did not get caught up in the "get rich quick" schemes of the 1980s. They stuck to the basics of housing finance, and as a group, are more profitable and better capitalized than ever before. The System's 2,164 traditional members own $8.4 billion of System capital and have borrowed $82.5 billion from the Bank System to support their residential and community development lending activities.

In total, the Bank System now serves 4,667 financial institutions. It is probably safe to say that a Bank System member can be found in virtually every community in the United States. Most important, the Bank System now supports a membership base that holds $884 billion in residential mortgage assets, or one out of every four single-family and multifamily mortgages in the country.

1992 HCDA Studies on the Federal Home Loan Bank System

With respect to the five studies, given the diversity of interests of those conducting the studies, it should come as no surprise that there were some differences of opinion . However, as noted at the beginning of this statement, more interesting in our view were the many areas of consensus.

Each study stresses the need for the System to maintain its traditional focus on lending to member institutions. Each study also supports a threshold commitment to residential lending in order to become a member of the System.

The Boston Bank concurs with these two findings.

All of the studies support a single, uniform set of rules for all members. All agree that membership should be voluntary, but some express the view that an all-voluntary membership approach should be linked to the creation of a "permanent" capital base. The linkage of voluntary membership with "permanent" capital stems from a concern over "membership risk," - - the risk that members will leave the System and redeem their capital investment.

The FHLB of Boston strongly endorses equal access for all members. The Bank also strongly supports voluntary membership for the System. We do not however consider "membership risk" to be an issue. We believe that universal voluntary membership is feasible even with no change in the System's capital structure.

The FHLB of Boston has historically had a very high percentage of voluntary members. This is due to the presence of state-chartered savings banks insured by the Bank Insurance Fund. These institutions have always been voluntary members of the Bank System. Thus, even before commercial banks and credit unions were granted access to the System on a voluntary basis in 1989, the stock of the FHLB of Boston was largely owned by voluntary members.

At year-end 1988, for example, voluntary members accounted for 70% of all members and held 68% of the Boston Bank's capital stock. Today, 81% of our members are voluntary, and they hold 84% of our capital stock. Those are the highest percentages of voluntary ownership among the 12 Banks. Systemwide, voluntary members account for 65% of all members and hold 37% of capital stock.

The long and successful experience that the FHLB of Boston has had with voluntary membership is strong evidence of the feasibility of voluntary membership Systemwide.

With regard to the System's capitalization, it is our view that the System's capital is more than adequate at the present time. We do not see a critical need for restructuring the System's capital, although enhancements such as tying the System's level of capital to its risk and creating a new layer of permanent capital may have merit. However, this issue requires a great deal of additional study and analysis before a definitive position can be taken.

The studies also support separating the Finance Board's dual responsibilities for governing and regulating the 12 Banks. The Boston Bank has long been a proponent of separating governance from regulation. We believe that the business management and corporate governance of a Bank should be vested in each Bank's Board of Directors.

The Federal Home Loan Bank of Boston

At the Federal Home Loan Bank of Boston, "New England's Housing Bank," we serve a membership comprised of savings banks, savings and loans, co-operative banks, commercial banks, credit unions and one insurance company, all with a demonstrated commitment to providing the residential and economic development credit needs of their communities.

Our members range in size from $10 million to $13 billion in assets. They serve a broad range of communities, from major urban centers in Connecticut, Massachusetts, and Rhode Island to rural communities in Vermont, New Hampshire, and Maine.

Our 373 members are very active lenders in their communities. Together, they hold over $73 billion of residential mortgage loans in their portfolios. 55% of our members were advance users as of March 31, 1994, with $6.7 billion in loans outstanding from the Boston Bank.

Housing and Community Development Programs of the FHLB of Boston

We take special pride, however, in our members' use of the Bank's three programs which target funds to underserved segments of the population: the AHP, CIP and New England Fund (NEF).

The success of these programs are due to the partnerships our members have established with community groups throughout New England.

Between 1990 and 1993, the FHLB of Boston's AHP provided $18.2 million in subsidies for 102 projects which have, or will produce 3,217 units of safe, decent and affordable housing for low-income families throughout New England.

Most importantly, 70% of these units will be affordable for very-low income families, those earning less than 50% of median income in their communities.

Also between 1990 and 1993, the FHLB of Boston disbursed $367.3 million in reduced-rate CIP advances and another $106.5 million in low-rate advances through the Bank's own NEF.

These advances have been used by members to fund over 7,600 units of housing and nine economic development projects and programs benefiting low- and moderate-income households and neighborhoods throughout New England.

Relative to the dollars involved in a HUD-type housing programs, these probably do not seem to be significant amounts. They are, however, extremely significant to the very-low and low-to-moderate income New Englanders who benefit.

The FHLB of Boston's AHP, CIP, and NEF help solve real housing problems. Some of these projects are small, others large, but they all have in common a partnership comprised of the Boston Bank, member lending institutions and dedicated community groups.

The Directors, officers and employees of the FHLB of Boston are understandably proud of the accomplishments of the AHP, CIP and the NEF. In fact, we have made it a point to provide the Directors and staff with opportunities to tour sites which have received Bank funding and to preview videotaped ribbon-cutting ceremonies and interviews with individuals whose lives have been positively affected by these programs.

Seeing the end product can be a very emotionally-uplifting experience. However, we continue to research ways to extend the Bank's support of affordable housing and community development initiatives in New England.

The Board of Directors of the FHLB of Boston recently approved a new initiative entitled Grants for New England Partnerships, or GNP, which will provide grants of up to $3,000 each to help fund the efforts of non-profit agencies selected by our members for their achievements in affordable housing or community development activities.

A second initiative involves a partnership between the Massachusetts Thrift Fund, a state-sponsored loan fund for affordable housing and community development, and the Boston Bank. The program, entitled the Massachusetts Community Building Program, will provide an estimated $25 million in subsidized loans to Massachusetts members for qualifying projects . The subsidies will be as high as 300 basis points for residential and economic development projects that target households earning less than 50% of median income.

We are also quite proud of our relationship with the New England state housing finance agencies (HFAs). Four of the six state HFAs have been approved as non-member borrowers, and a fifth has applied for non-member borrower status.

The FHLB of Boston was the first FHLB to lend to an HFA, providing a line of credit to support a reverse annuity mortgage program for low-income elderly citizens of Rhode Island. In addition, the Bank has provided long-term advances to both the Massachusetts and Rhode Island HFAs to support multi-family preservation projects occupied by very-low and low-income families.

Finally, we have organized a Task force with the New England HFAs to identify ways in which we can participate in the preservation and risk-sharing programs between HUD and qualifying HFAs.

These initiatives clearly underscore the FHLB of Boston's commitment to affordable housing and community development.

H.R. 3474 - - The Community Development Financial Institutions Act

Finally, Mr. Chairman, we would like to discuss certain amendments to the Federal Home Loan Bank Act included in the House version of the Community Development Financial Institutions Act. If those provisions are enacted into law, federally-insured community development financial institutions could access advances without having to purchase stock in the Bank System. The Bank System could accept, as collateral, loans made by members using CIP advances. Bank System members could exclude CIP advances in calculating their stock purchase requirements. Finally, the amount of advances the Bank System could have outstanding to non-QTL members, would be increased from 30% to 40% of total Bank System advances.

These amendments were offered by Congressman Richard Baker. The changes which the Baker amendments seek are modest, yet at the same time, important if the System is to continue the progress it has made since 1989.

Mr. Baker has been a true champion of the Federal Home Loan Bank System and his efforts to legislate changes which will allow the System to more effectively meet the residential and community lending needs of our members are widely recognized and greatly appreciated.

The FHLB of Boston supports the amendments offered by Mr. Baker and urges the House and Senate conferees to include those amendments in the final bill that is sent to the President for his signature.

Some have argued that the Baker amendments constitute "piecemeal" reform of the Bank System and for that reason should not be supported. Proponents of that view maintain that what the System needs is comprehensive legislation

We fail to understand the logic of that position. While supporting the Baker amendments, we also support comprehensive legislation. It is our position that passage of the Baker amendments will enhance the System's mission and, most important, provide additional time to develop comprehensive legislation in a rational manner.

Although we support all of the amendments, I would like to make several points regarding the amendment raising the ceiling on advances to non-QTL members from 30% to 40% of all System advances.

The current ratio of advances to non-QTL members lies somewhere in the range of 8% to 16%. The upper end of that range is the ratio of advances to all non-thrift members. However, some of those members pass the 65% QTL test and can be classified as "non-thrift QTL members." The lower end of the range is the Finance Board's estimate of advances to non-QTL lenders taking that factor into account.

While there is little in the way of historical trends in this area, it should be noted that advances to commercial banks doubled in 1993, from $8 to $16 billion, and that there continues to be the potential for advances to commercial banks to grow exponentially. More than half of all System members are commercial banks, and nearly half of these commercial bank members are borrowers.

No matter which ratio is utilized, it is not possible to project them with any certainty. At the FHLB of Boston, we have concluded that the non-thrift lending ratio could exceed 30% by late 1995. We consider that projection to be reasonable given:

- that commercial banks now hold more residential mortgage assets than savings institutions;

- that commercial banks are the fastest growing segment of the Bank System's membership; and

- the propensity of these new members to borrow advances.

However, that does not preclude the ratio from crossing the 30% threshold earlier or later. There are just too many factors--none of which the Bank System controls--that influence those ratios. The very existence of a lending cap in the face of such uncertainties is what causes us the most concern.

The modest change proposed by the Baker amendment provides additional lending capacity to the System while more comprehensive legislation is being considered. Indeed, it is difficult to understand how the System and its shareholders would benefit from being forced into an arbitrary credit allocation which is totally unrelated to the housing finance activities of its members.

On behalf of the Boston Bank, I would like to thank Chairman Flake and the other members of the subcommittee for providing the Bank with this opportunity to express our views on these important matters

Federal Home Loan Bank of Boston

"New England's Housing Bank"

STATEMENT OF

MICHAEL A. JESSEE

PRESIDENT OF THE FEDERAL HOME LOAN BANK OF BOSTON

TO THE SUBCOMMITTEE ON GENERAL OVERSIGHT, INVESTIGATIONS AND THE RESOLUTION OF FAILED FINANCIAL INSTITUTIONS

OF THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

U.S. HOUSE OF REPRESENTATIVES

MAY 24, 1994

Introduction and Overview

Mr. Chairman and Members of the Subcommittee, as President and Chief Executive Officer of the Federal Home Loan Bank (FHLB) of Boston and on behalf of its Board of Directors, officers and employees, and 373 shareholders throughout New England, I am pleased to submit this written statement concerning recently published studies on the Federal Home Loan Bank System.

Mr. Chairman, we very much appreciate your interest in the Bank System, and we want to express our sincere thanks to you for holding this hearing.

As mandated by the Housing and Community Development Act of 1992 (HCDA), the Federal Housing Finance Board (Finance Board), the General Accounting Office, the Congressional Budget Office, the Department of Housing and Urban Development (HUD), and a group of 24 of the System's shareholders, two from each of the 12 Banks, studied the FHLB System and submitted recommendations to Congress concerning the System's future structure and role.

With the release of the HUD study on April 25, 1994, all five studies have now been completed. What is perhaps most remarkable about the five reports, is the degree of consensus and agreement on the major issues:

- First, the reports conclude that the System operates safely and soundly. This has been true of the System throughout its 62-year history and should come as no surprise to those familiar with the System's conservative financial management.

- Second, the studies find that the System fulfills a valuable purpose in the Nation's housing finance system by enhancing the ability of its member lending institutions to hold residential mortgage assets in portfolio. The Bank System accomplishes this by providing collateralized loans, or advances, to its members and by serving as a source of liquidity.

- Third, because the System is well operated and fulfills an important public policy purpose, none of the studies recommend drastic reform. The recommendations contained in the five studies aim to enhance the System's ability to fulfill its housing finance mission. These enhancements include voluntary membership, equalizing the terms of access for all members, structuring a risk-based capital standard for the System, and vesting the corporate governance of the Banks in the Boards of Directors of each Bank--all of which the FHLB of Boston endorses.

We look forward to working with the Congress and the Administration to develop legislation to implement these important enhancements.

As the debate on these proposals ensues, however, it will be important to keep in the mind the following statement of HUD Secretary Henry G. Cisneros in the Foreword to HUD's well-researched and clearly written study:

> HUD is convinced that portfolio lending in support of residential mortgage financing continues to be critically important today, and support to mortgage portfolio lenders should remain the core function of the Federal Home Loan Bank. ... HUD is confident that a Federal Home Loan Bank System that is fiscally sound, prudently and equitably managed, competitive in the marketplace, and committed to its community lending purposes will remain a vital force in the housing finance system of the next century.[1]

We at the Federal Home Loan Bank of Boston could not agree more. Certainly, the mortgage finance system is much different today than it was 62 years ago, or even 20 years ago. But the System's basic mission--"enhancing the capacity of member lending institutions to hold residential mortgages in portfolio"[2]--is as relevant today as it was when the System was created 62 years ago.

Of course, it is incumbent upon the Bank System, as a profit-making and federally chartered enterprise, to assess how it should respond to marketplace challenges so that it can continue to fulfill an important role in the Nation's housing finance system. At the same time, it is important to acknowledge the many ways in which the System already has responded to these changes.

The HCDA of 1992 recognized that certain of these changes were brought about by the Financial Institutions, Reform, Recovery and Enforcement Act of 1989 (FIRREA). Since FIRREA permanently altered the nature of the Bank System, it is probably worthwhile to briefly summarize those changes.

First, the System was required by FIRREA to establish an Affordable Housing Program (AHP) and a Community Investment Program (CIP) to provide below-cost loans and grants for affordable housing and community development purposes. The results of these two programs have been impressive. In partnership with the System's members and community groups and with the advice and counsel of the Banks' Affordable Housing Advisory Councils, the AHP and CIP have helped produced 185,000 units of safe and decent housing for very-low and low-to-moderate income families throughout the U.S.

Under the statutory provisions of the AHP, the System sets aside a minimum amount of its earnings each year to be used as subsidies for low- and moderate-income

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[1] "Report to Congress on the Federal Home Loan Bank System: Summary Analysis and Policy Recommendations," Department of Housing and Urban Development, Foreword, 1994.
[2] Ibid.

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housing. Beginning in 1994 and each year thereafter, the System must set aside the greater of 10% of its earnings or $100 million for use as subsidies in the following calendar year. From the AHP's inception in 1990 through 1993, the System has contributed $233.9 million of its earnings to the AHP. These funds have been used to subsidize advances and to provide grants to facilitate the purchase, construction, or rehabilitation of 62,425 housing units. Of the units subsidized with AHP funds, 64% have been for very-low income households, i.e., households with incomes of less than 50% of the area median.

Through the CIP, the System has disbursed $4.5 billion in advances priced at its cost of funds (plus a small administrative mark-up) to be used by members for low- and moderate-income housing loans and economic development loans in distressed areas. CIP advances have funded 122,600 housing units and 136 economic and community development projects.

Both the AHP and CIP have received universal acclaim for the flexible and efficient manner in which these subsidies have been delivered. Because the production of affordable housing targeting very-low and low-to-moderate income households is typically complex and often involves numerous funding sources, the AHP in particular often provides the critical "gap" funding necessary for a project to go forward.

The second major change ushered in by FIRREA was an expansion of the Bank System's eligible membership base. Until 1989, membership in the Bank System was limited to savings and loans, savings banks and insurance companies. However, with the passage of FIRREA, commercial banks and credit unions with a demonstrated commitment to housing finance were allowed to apply for membership. In so doing, Congress ensured that the Bank System's support of mortgage portfolio lenders would be available to all depository institutions engaged in home mortgage lending.

There is perhaps no truer indication of the value of Bank System membership than what has subsequently occurred. Through March 31, 1994, 2,503 commercial banks and credit unions have elected to join the System. These new members have purchased $3.1 billion in System capital stock and have borrowed $16.6 billion from the 12 Banks. Overall, these new commercial bank and credit union members make up 53.6% of all System members, own 27.1% of the System's capital and represent 16.8% of our lending activity. Commercial banks and credit unions continue to express interest in joining the System. As of March 31, 1994, 265 commercial banks and credit unions were in the application pipeline either at the 12 Banks or the Finance Board.

However, it is equally important not to overlook the Bank System's traditional membership base of savings and loans and savings banks. These are community lenders that did not get caught up in the "get rich quick" schemes of the 1980s. They stuck to the basics of housing finance, and as a group, are more profitable and better capitalized than ever before. The System's 2,164 traditional members own $8.4 billion of System capital and have borrowed $82.5 billion from the Bank System to support their residential and community development lending activities.

In total, the Bank System now serves 4,667 financial institutions. It is probably safe to say that a Bank System member can be found in virtually every community in the United States. Most important, the Bank System now supports a membership base that holds $884 billion in residential mortgage assets, or one out of every four single-family and multifamily mortgages in the country.

While FIRREA contained some positive features for the Bank System, it also imposed some significant costs on the System related to the failure of a sizable number of savings and loans. These costs included the confiscation of $2.5 billion of retained earnings and the imposition of an annual $300 million fixed assessment to the Resolution Funding Corporation (REFCorp), the funding arm of the Resolution Trust Corporation. In the face of declining advances in the immediate post-FIRREA period, the Bank System increased its investment portfolio to meet this fixed obligation. While the fixed REFCorp assessment is burdensome, especially given the cyclicality of the System's business, and complicates the System's housing finance mission, the pertinent fact is that the System is managing to meet the obligation.

Thus, notwithstanding the loss of retained earnings and the REFCorp assessment, the Bank System has not only survived the changes wrought by FIRREA, but it has emerged in many ways stronger, more focused and eager to continue its historic role of providing valuable credit and other services in support of the System's housing mission.[3]

The Bank System has become a customer-driven enterprise, delivering innovative products and services that help its customers--its member lending institutions--respond to the housing and other credit needs of the communities they serve. The results of these efforts are exhibited not only by the growth in membership, but by the growth in the Bank System's main line of business: advances to member institutions. Since year-end 1991, advances have increased 26%, to just under $100 billion. Significantly, the number of members borrowing from the System has nearly doubled over the same time period, from 1,256 at year-end 1991 to 2,258 at the end of March 1994.

The number of members borrowing from the System is only part of the story. Member institutions--and the communities that they serve--benefit from the Bank System even if they do not borrow. The reason is that the System provides member institutions with a readily-available source of liquidity. Because they can readily access funds from the Bank System, members need to hold less low-yielding, liquid assets in their portfolios and can hold more mortgage assets than would otherwise be possible. In particular, having access to liquidity means that members can hold loans that do not conform to the strict criteria of the secondary mortgage market. Members can apply underwriting terms

[3] See Attachment A for graphs and tables depicting the positive financial trends and contribution to affordable housing and community development of the System and the FHLB of Boston in the post-FIRREA era.

tailored to the markets they serve, and they can still liquefy those loans, if necessary, by borrowing advances from the Bank System.

The System also has exhibited positive financial trends. During March 1994, the Bank System's capital averaged just under $12 billion. Most of the System's capital was in the form of member-owned stock. The System's capital-to-asset ratio was a solid 6.7%, and its risk-based capital ratio based on commercial bank standards was nearly 30%.

With respect to profitability, the System earned $895 million in 1993, up 5% from 1992's earnings of $850 million. It was the first increase in earnings since 1989. In the first quarter of 1994, the System recorded net income of $254 million, up 25% from net income of $204 million in the first quarter of 1993.

It cannot be emphasized enough how important it is for the System to generate healthy earnings. It is the System's earnings, after all, that allow it:

- to meet its $300 million a year obligation to the REFCorp;
- to contribute a minimum of $100 million each year to the AHP;
- to provide an implicit subsidy estimated at $7 million by making CIP advances at essentially its cost of money; and
- to provide the technical assistance and outreach that have made the AHP and CIP such well-recognized successes.

Strong earnings also are needed to pay dividends to the shareholders of the System. This need was expressed in the Finance Board's report to Congress on the Bank System:

> Unlike a private corporation, the primary purpose of the Bank System is not to increase the wealth of its shareholders through the payment of high dividends. Nevertheless, it is important to appreciate that the Bank System cannot fulfill its public policy purpose without the investment of its members. As the System attracts more and more voluntary members, it is important that it pay a dividend, that, when combined with the other benefits of membership, make membership an economically rational choice.[4]

[4] "Report on the Structure and Role of the Federal Home Loan Bank System," Federal Housing Finance Board, p. 27, 1993.

As the Congress, the Administration, and the Bank System consider legislative change to the System's structure and role, it is vital that this balance of public and private interests be maintained.

There is one other reason why the continuation of solid and consistent earnings is important to the System and to the American taxpayer: it is one of the attributes that has cemented the Bank System's triple-A credit rating. The Bank System is one of only 12 financial institutions worldwide that can boast a triple-A credit rating. Maintenance of the triple-A rating is a top priority for the System, and that means that the System must maintain steady earnings, strong capital, sound management, and superb asset quality. Any change which alters these attributes in a negative manner, e.g., an increase in the System's risk profile, would endanger this triple-A rating.

In summary, despite the many changes that have occurred since 1932, the mission outlined by Secretary Cisneros--the support of member institutions that hold residential mortgages in portfolio--remains the principal role of the Bank System. The Bank System's primary strength is its network of nearly 4,700 commercial bank, savings and loan, savings bank, credit union and insurance company members. The Bank System's main objective should be to help preserve the viability of depository institutions as residential lenders and providers of financial services in their communities. To do so, the Bank System must continue to serve as a source of liquidity to its members. It also must be innovative in responding to its members' needs, while operating in a safe, sound and profitable manner. Thus, legislation concerning Bank System issues raised in the HUD study and echoed in the other four reports should be geared towards enhancing, not detracting from, the Bank System's existing sound structure and important mission.

1992 HCDA Studies on the Federal Home Loan Bank System

It is within the context of enhancing the System's structure and mission that Congress should consider the recommendations of the five HCDA studies. All of the studies were very well done, but we were especially impressed with the effort put forth by HUD. In particular, we found the HUD report remarkably consistent with the Bank System's own strategic planning effort, "System 2000."[5]

As chairman of the Bank Presidents' Planning Committee when System 2000 was started and as chairman of the Bank Presidents' Conference when the development phase of System 2000 was finished and the implementation phase was begun, I take particular pride in HUD's statement that System 2000's statements of the Bank System's mission, vision and values "are fully consistent with, and complement, this report's proposed statement of purpose" for the Federal Home Loan Bank System.[6]

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[5] Attachment B includes System 2000's statements of mission, vision and values for the Bank System and presents a status report on implementation as of the end of March 1994.
[6] HUD report, pp. 21-22.

System 2000 has been adopted by the constituent parts of the Bank System--including its shareholders, the Boards of Directors of the 12 Banks, the management of the 12 Banks, and the Finance Board--and represents a consensus view of the System's structure and role. As such, the System 2000 strategic framework should be factored in as legislative reform of the Bank System is contemplated.

With respect to the five HCDA studies, given the diversity of interests of those conducting the studies, it should not come as a surprise that there were some differences of opinion on the fourteen questions that each entity was asked to address. However, as noted at the beginning of this statement, more interesting in our view were the many areas of consensus.

Each study stresses the need for the System to maintain its traditional focus on lending to member institutions, rather that embarking on direct lending initiatives that would effectively compete with its members and potentially increase the System's risk profile. Each study also supports a threshold commitment to residential lending in order to become a member of the System.

The FHLB of Boston concurs with these two findings. They, in essence, ratify and confirm the value of the Bank System's long-standing public policy purpose, in which the FHLB of Boston strongly believes.

All of the studies support the elimination of the varying rules on borrowing and capital stock purchases, instead favoring a "level playing field" where a single, uniform set of rules would apply to all members. All agree that membership should be voluntary, but some express the view that an all-voluntary membership approach should be linked to the creation of a "permanent" capital base. The linkage of voluntary membership with "permanent" capital stems from a concern over "membership risk," i.e. the risk that members will leave the System and redeem their capital investment.

The FHLB of Boston strongly endorses equal terms of access for all members. The Bank also strongly supports voluntary membership for the System. We do not consider "membership risk" to be an issue. We believe that voluntary membership is feasible even with no change in the System's capital structure.

The FHLB of Boston confidently takes this position with respect to voluntary membership since it is unique among the 12 Banks in that it has historically had a very high percentage of voluntary members. This is due to the fact that the savings institutions business in the northeastern United States, and in New England in particular, has been dominated by state-chartered savings banks insured by the Bank Insurance Fund. These institutions have always been voluntary members of the Bank System. Thus, even before commercial banks and credit unions were granted access to the System on a voluntary basis in 1989, the stock of the FHLB of Boston was largely owned by voluntary members. At year-end 1988, for example, voluntary members accounted for 70% of all members and held 68% of the Bank's capital stock. Today, 81% of the members of the FHLB of

Boston are voluntary, and they hold 84% of the Bank's capital stock. Those are the highest percentages of voluntary ownership among the 12 Banks. Systemwide, voluntary members account for 65% of all members and hold 37% of capital stock.

The long and successful experience that the FHLB of Boston has had with voluntary membership is strong evidence of the feasibility of voluntary membership Systemwide. It also is proof that voluntary membership is compatible with fulfillment of the Bank System's housing finance mission. The key is that the Bank System must deliver real economic benefit to its members, as measured by the value of the services it provides and by the dividends its pays on member-owned capital stock.

With regard to the System's capitalization, there appears to be a consensus that any new capital requirements should be risk-based, although views vary as to whether the federal banking regulatory approach, the approach taken by the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac), or some third methodology should be employed. As noted under the discussion of voluntary membership, some of the studies recommend establishment of a "permanent" capital base.

It is the view of the FHLB of Boston that the System's capital is more than adequate at the present time. We do not see a critical need for restructuring the System's capital, although enhancements such as tying the System's level of capital to its risk and creating a new layer of permanent capital may have merit. However, this issue requires a great deal of additional study and analysis before a definitive position can be taken.

The studies also support separating the Finance Board's dual responsibilities for governing and regulating the 12 Banks. There is general agreement that the System should have a strong safety and soundness regulator that is not involved in the business management of the Banks. Corporate governance and business management should be vested in the Boards of Directors of the 12 Banks. While the studies vary in their opinions concerning the need for a central business coordinator or policy entity for the 12 Banks, there does appear to be consensus that such a coordinator or entity should not be imposed upon the System, but, rather, it should come from within the System.

The FHLB of Boston has long been a proponent of separating governance from regulation. We believe that the business management and corporate governance of a FHLB should be vested in each FHLB's Board of Directors. We see no need for a central business leader, central policy entity, or program coordinator that in anyway would interfere with or infringe upon the authority of the FHLB of Boston's Board of Directors. Furthermore, if the System at some point in time should create such a central body, any authority it has should come from the Boards of Directors of each FHLB. We firmly believe that a strong safety and soundness regulator and clearly defined policy and program parameters in statute should be

more than adequate safeguards for a financial system that is privately capitalized and subject to financial market discipline.

The studies also concur that the REFCorp assessment is burdensome. A fixed tax is not an optimal means of assessing an enterprise whose very business is of a cyclical nature. Nevertheless, it is a cost burden that the System has been managing successfully since 1989 by utilizing its increased investment authority. Moreover, there is a general perception in the studies that the growth in membership and advances should help the System meet this obligation over time. As stated by HUD in its report:

> If advances continue to increase, the ability of the System to provide the amounts envisioned in FIRREA would not be threatened, unless adverse changes in the economic environment or rates of return to the FHLBanks on advances and other investments should occur.[7]

Proposals to lift the obligation entirely or to change the assessment from a fixed dollar amount to a variable amount based on the System's earnings capacity were considered to have merit. However, several of the studies cited obstacles to changing the obligation, including the "pay-as-you-go" provisions as they relate to the Federal Government's budget deficit. As a consequence, HUD, as an example, made no recommendations to change the REFCorp payment arrangement.

In general, we were very impressed with the thorough and thoughtful nature of the conclusions reached in the studies and believe that they should prove helpful in identifying areas deserving Congressional attention. However, we strongly urge that any legislative initiative fully recognize the successes that the System has realized not only over the past five years, but throughout its 62-year history. As the old saying goes, "if it ain't broke, don't fix it." Not only is the System not broke, it has an impressive list of achievements, and is poised to play an even greater role in meeting the Nation's residential and community lending needs. Any legislative changes must be carefully developed to enhance not distract, from the System's ability to fulfill that mission.

The Federal Home Loan Bank of Boston

At the FHLB of Boston, "New England's Housing Bank," we serve a membership comprised of savings banks, savings and loans, co-operative banks, commercial banks, credit unions and one insurance company, all with a demonstrated commitment to providing the residential and economic development credit needs of their communities. Our members range in size from $10 million to $13 billion in assets. They serve a broad range of communities, from major urban centers in Connecticut, Massachusetts, and Rhode Island to rural communities in Vermont, New Hampshire, and in the northernmost reaches of Maine.

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[7] HUD report, p. 18.

The 373 member lending institutions of the FHLB of Boston are very active lenders in their communities. Together, these community lenders hold over $73 billion of residential mortgage loans in their portfolios, representing more than 53% of their total assets. Of these members, 55% were advance users as of March 31, 1994, with $6.7 billion in loans outstanding from the FHLB of Boston.

Given the ability of the FHLB of Boston to attract new members and to retain existing members, there is little doubt that it is providing real economic value to its members. For example, although advance growth for the Bank has tapered off in the early months of 1994, advances at the end of the first quarter were still 34% above the year-end 1992 total of $5.0 billion. This growth can be attributed to the increase in membership--the FHLB of Boston added 42 new members in 1993--and to the improved economic conditions in New England. In addition, the FHLB of Boston offers a very attractive array of lending products to meet the members' financial needs, and that has certainly contributed to an increase in advances. Indeed, approximately 30% of the Bank's outstanding advances today are in lending products that did not exist before 1989.

The FHLB of Boston also provides its members with other valuable services including letters of credit so that members can take advantage of the Bank's triple-A rating; interest rate swaps, caps, collars and floors that help members manage their interest-rate risk; cash management services; investment services including three high-quality deposit products and a safekeeping/trading service; and technical assistance that helps members to make the most of their financial resources to better meet community credit needs.

The FHLB of Boston offers these valuable services to members in a safe, sound, and profitable manner. By virtue of its more than $900 million in member-owned capital stock, the FHLB of Boston had a capital-to-asset ratio that averaged 7.43% during the first quarter of 1994. As is the case with all the FHLBs, the FHLB of Boston is exposed to little, if any, credit risk. Moreover, the Board of Directors of the FHLB of Boston has established very conservative financial management policies that strictly limit the Bank's exposure to interest rate fluctuations.

From a profit standpoint, the FHLB of Boston earned $57.4 million in 1993, compared with $52.4 million in 1992. As was the case for the System as a whole, the increase in earnings in 1993 was the first for the FHLB of Boston since 1989. The Bank paid its shareholders a dividend of 7.58% in 1993, which was 450 basis points above the annual average bond-equivalent yield on three-month Treasury bills. In the first quarter of 1994, the Bank earned just under $15 million and paid a 7.00% dividend, which was 366 basis points above the three-month T-bill yield index.

Housing and Community Development Programs of the FHLB of Boston

We are very proud of the membership and financial gains that the FHLB of Boston has made since 1989. We take special pride, moreover, in seeing our members become active users of the Bank's three programs which target funds to underserved segments of the population: the AHP, CIP and New England Fund (NEF). While these are the Bank's programs, the successes recorded by these programs are due to the Bank's members and to the partnerships those members have established with community groups throughout New England.

The Bank's Affordable Housing Advisory Council (AHAC), created by FIRREA, has played a key role in the successes of the Bank's AHP, CIP and NEF. The constructive relationship between the Bank and AHAC has significantly contributed to the achievement of the Bank's affordable housing and community development goals. This is a direct result of the open lines of communication between the Bank and the AHAC about their hands-on, day-to-day experience with affordable housing and community development challenges confronting New Englanders. The AHAC also has played a key role in linking Bank members with community non-profit organizations actively involved in affordable housing and community development; in spreading the word about the programs offered by the Bank; and in encouraging non-member financial institutions to join the FHLB of Boston.

Between 1990 and 1993, the FHLB of Boston's AHP provided $18.2 million in subsidies for 102 projects which have or will produce 3,217 units of safe, decent and affordable housing for low-income families throughout New England. Most importantly, 70% of these units will be affordable for very-low income families, those earning less than 50% of median income in their communities.

Also between 1990 and 1993, the FHLB of Boston disbursed $367.3 million in reduced-rate CIP advances and another $106.5 million in low-rate advances through the Bank's own NEF. These advances have been used by members to fund 7,659 units of housing and nine economic development projects and programs benefiting low- and moderate-income households and neighborhoods throughout New England.

Relative to the dollars involved in a HUD-type housing programs, these probably do not seem to be significant amounts. They are, however, extremely significant to the very-low and low-to-moderate income New Englanders who benefit. The FHLB of Boston's AHP, CIP, and NEF help solve real housing problems. Some of these projects are small, others large, but they all have in common a partnership comprised of the FHLB of Boston, member lending institutions and dedicated community groups.

A small sample of the range of housing problems addressed by these programs and the people who have benefited should provide a flavor for why these programs are hailed as models for other governmental housing programs[8]:

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[8] Attachment C lists all of the AHP projects approved by the FHLB of Boston in 1993.

- Addressing the Problem of Homelessness--

  Formerly homeless families are among the occupants of nine newly-constructed townhouse units in New Haven, Connecticut. Designed specifically for very low-income renters, Blake Street Homes provides renters with a voice in the ongoing management of the project. AHP funds were provided through American National Bank (now a part of Lafayette Bank and Trust).

  The Kennebec Valley Community Action Program has acquired and is in the process of rehabilitating a building in Waterville, Maine, that will provide two units of transitional housing for homeless teenage parents. The teens will be provided with a case manager to assist them in becoming self-sufficient. Kennebec Savings Bank intends to use a CIP advance to provide the project with fixed-rate permanent financing.

- Meeting Special Needs--

  Ruah, Hebrew for "Breath of Life," with AHP funds provided through North Cambridge Cooperative Bank, will provide seven units of housing in Cambridge, Massachusetts, for homeless women with AIDS. Supportive services will include identification of medical, psychological and counseling resources to meet the residents' individual needs, as well as training and counseling to maximize each resident's ability to live independently.

  With CIP financing provided by Franklin Lamoille Bank, St. Albans, Vermont, proceeds from the sale of tax credits awarded to the project, a Home Ownership Made Easy (HOME) grant, financing from the Vermont Housing and Conservation Board, and several other grants and loans, twenty-three new apartments are now occupied by low- and moderate-income elders in Franklin. In addition to one- and two-bedroom apartments, the building includes common kitchen and dining areas and space for recreation and meetings.

- Providing Residents with Control of Their Housing--

  Families have already moved into five of the thirteen newly renovated apartments making up Princeton Place Cooperatives in Providence, Rhode Island. The target market for these apartments are low and very low-income households with stable incomes who cannot afford traditional homeownership. According to SWAP, the non-profit developer of this project, these households "will now be provided the opportunity to gain greater control and security through cooperative ownership". AHP funding, a key component of the financing package, was provided through Citizens Savings Bank of Providence.

- Providing Secure and Stable Environments for Families--

  Twenty-six families are now at home in a new community of three-bedroom townhouses in Concord, New Hampshire developed by the Concord Area Trust for Community Housing. These low- and very low-income families were chosen on the basis of their interest in working with their neighbors to develop a new community and will all participate in the process of forming the cooperative that will own and manage the project. AHP funding was provided through the Concord Savings Bank.

The housing produced with the assistance of the AHP, CIP and NEF is the result of a cooperative effort on the part of lenders and community-based organizations. The process of developing proposals and preparing applications for funding has resulted in new and improved relationships between lenders and community groups. As lenders explore new ways for meeting the needs of their communities and as non-profit developers find that public funding is not available in the amounts necessary to cover total development costs, there has grown a new appreciation for the role each party can play. With lenders and non-profits building on each other's strengths, the communities they serve will surely benefit. Improving the communication between lenders and non-profit community groups is one of the nonquantifiable but nevertheless significant benefits provided by the AHP, CIP and NEF.

The Directors, officers and employees of the FHLB of Boston are understandably proud of the accomplishments of the AHP, CIP and the NEF. In fact, we have made it a point to provide the Directors and staff with opportunities to tour sites which have received Bank funding and to preview videotaped ribbon-cutting ceremonies and interviews with individuals whose lives have been positively affected by these programs.

Seeing the end product can be a very emotionally-uplifting experience. However, we continue to research ways to extend the Bank's support of affordable housing and community development initiatives in New England. The Board of Directors of the FHLB of Boston recently approved a new initiative entitled Grants for New England Partnerships, or GNP, which will provide grants of up to $3,000 to help fund the efforts of non-profit agencies selected by our members for their achievements in affordable housing or community development activities.

A second initiative involves a partnership between the Massachusetts Thrift Fund, a state-sponsored loan fund for affordable housing and community development, and the FHLB of Boston. The program, entitled the Massachusetts Community Building Program, will provide an estimated $25 million in subsidized loans to Massachusetts members for projects that meet the criteria of the Bank's CIP and Thrift Fund. The subsidies will be as high as 300 basis points for residential and economic development projects that target households earning less than 50% of median income.

We are also quite proud of our relationship with the New England state housing finance agencies (HFAs). Four of the six state HFAs have been approved as non-member borrowers, and a fifth has applied for non-member borrower status. The FHLB of Boston was the first FHLB to lend to an HFA, providing a line of credit to support a reverse annuity mortgage program for low-income elderly citizens of Rhode Island. In addition, the Bank has provided long-term advances to both the Massachusetts and Rhode Island HFAs to support multi-family preservation projects occupied by very-low and low-income families.

Finally, we have organized a Task force with the New England HFAs to identify ways in which we can participate in the preservation and risk-sharing programs between HUD and qualifying HFAs.

These initiatives clearly underscore the FHLB of Boston's commitment to affordable housing and community development.

H.R. 3474 - - The Community Development Financial Institutions Act

We agree with those who call for "comprehensive" legislation to address the types of recommendations made in the HUD report and in the other four studies of the Bank System. However, we also recognize that crafting comprehensive legislation takes time. In fact, in the case of the Bank System, we would argue that since the System is not in a state of crisis and is functioning quite well, that comprehensive legislation should be developed slowly and deliberately.

In that regard, Mr. Chairman, we would like to discuss certain amendments to the Federal Home Loan Bank Act included in the House version of the Community Development Financial Institutions Act. Specifically, I am referring to Sections 220 through 222 of H.R. 3474. If those provisions are enacted into law, insured community development financial institutions (CDFIs) and community development credit unions could access advances without having to purchase stock in the Bank System. The Bank System could accept as collateral loans made by members using CIP advances. Bank System members could exclude CIP advances in calculating their stock purchase requirements. Finally, the amount of advances the Bank System could have outstanding to non-Qualified Thrift Lender (non-QTL) members, i.e. basically commercial banks and credit unions, would be increased from 30% to 40% of total Bank System advances.

These amendments were offered by Congressman Richard Baker (R-LA). The changes which the Baker amendments seek are modest, yet at the same time, important if the System is to continue the progress it has made since 1989. Mr. Baker has been a true champion of the Federal Home Loan Bank System and his efforts to legislate changes which will allow the System to more effectively meet the residential and community lending needs of our members are widely recognized and greatly appreciated.

The FHLB of Boston supports the amendments offered by Mr. Baker and urges the House and Senate conferees to include those amendments in the final bill that is sent to the President for his signature. Those amendments are consistent with the FHLB of Boston's mission of supporting affordable housing and economic development in New England. They will allow the FHLB of Boston to support the Administration's goals behind the CDFI concept. They also will guarantee that the FHLB of Boston can continue to offer a stable, low-cost source of funds to all its members, including its growing clientele of commercial bank members.

Some have argued that the Baker amendments constitute "piecemeal" reform of the Bank System and for that reason should not be supported. Proponents of that view maintain that what the System needs is comprehensive legislation We fail to understand the logic of that position. While supporting the Baker amendments, we also support comprehensive legislation. It is our position that passage of the Baker amendments will enhance the System's mission in a small way and, most important, provide additional time to develop comprehensive legislation in a rational manner.

The first amendment would allow CDFIs to have access to the System's advances window without becoming members. Several points should be noted. First, only CDFIs that are federally insured depositories would be eligible. Thus, these entities would be subject to the federal regulatory oversight mechanisms. Second, as non-member borrowers, CDFIs would be subject to more restrictive borrowing requirements than members. Third, as noted earlier by the overwhelming success of our new member recruitment efforts, it is very likely that these CDFIs would prefer to apply for membership in any event. Fourth, those CDFIs that might choose the non-member borrower approach would more than likely be small in size and therefore not have any meaningful impact on the leveraging capacity of a System which views itself as significantly overcapitalized.

Similarly, waiving capital stock purchase requirements on CIP advances poses no measurable increased risk to the Banks, since we look primarily to eligible housing collateral, not capital stock, to protect the Banks from credit risk. Additionally, waiving incremental stock purchase requirements triggered by CIP advances, which must by statute be made at a Bank's cost of funds, avoids dilution of the dividend earning capacity of the rest of the stock outstanding.

The third provision of the Baker amendments would permit the Banks to accept community development loans as collateral. Because this is a "permissive" provision and a Bank is free to determine the market value of these loans and apply any discount or "haircut" to that value that a Bank may determine is appropriate, we see no reason why such loans should not be considered eligible collateral.

The final Baker amendment would raise the aggregate ceiling on advances to non-QTL members (those with less than 65% of qualifying mortgage assets relative to their "portfolio assets," i.e. basically tangible non-liquid assets) from 30% to 40% of all System advances. This rule only limits the System's commercial bank, credit union and insurance company members, because only savings and loans are required, in effect, to pass the test by their enabling statute, the Home Owners Loan Act of 1933, or convert their charter to that of a national bank.

The current ratio of advances to non-QTL members lies somewhere in the range of 8% to 16%. The upper end of that range is the ratio of advances to all non-thrift members. However, some of those members pass the 65% QTL test and can be classified as "non-thrift QTL members." The lower end of the range is the Finance Board's estimate of advances to non-QTL lenders taking that factor into account.

As in most cases, the truth probably lies somewhere in the middle. As the Finance Board stated in memoranda to the Treasury and to staff of Mr. Baker and Senator Donald Riegle (D-MI):

> Based on the assumption that advances to all non-savings association members of the System...represent the maximum amount of the advances that can be outstanding to non-QTL members at present, 16 percent of FHLBank advances are outstanding to this group of members. However, since there are non-savings associations that meet the 65 percent QTL standard and are thus considered QTLs for the purpose of the 30 percent borrowing limit, we calculate the actual percentage of advances outstanding to non-QTL members to be approximately 8 percent as of year-end 1993.
>
> We should point our that five of the System's largest commercial bank borrowers have QTL ratios between 65 and 68 percent and, thus, minor changes to their asset mix could alter their QTL status. Including these institutions in the non-QTL group...would increase the percentage of non-QTL advances to total advances to 11 percent.
>
> While there is little in the way of historical trends in this area, it should be noted that advances to commercial banks doubled in 1993, from $8 to $16 billion, and that there continues to be the potential for advances to commercial banks to grow exponentially. More than half of all System members are commercial banks, and nearly half of these commercial bank members are borrowers. The potential for non-QTL commercial banks to become a larger segment of the System's borrowing base makes projections as to when the 30 percent limit will be exceeded quite speculative.[9]

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[9] "Data on FHLBank Non-QTL Lending," memorandum from Rita I. Fair, Acting Managing Director, Federal Housing Finance Board, to Joan Affleck-Smith, Director, Office of Thrift Institution Oversight & Policy, U.S. Department of Treasury, May 6, 1994. Identical document sent by K. Scott Baker, Federal Housing Finance Board, to Duane Duncan of Mr. Baker's staff and to Patrick Lawler, a staff member of the Senate Banking Committee.

There are several facets to the Finance Board's statements that should be appreciated. First, commercial banks and credit unions are not required to maintain QTL status to access advances. Since the composition of their assets will vary over time, commercial banks and credit unions may move in and out of QTL status. Hence, for a given membership base, the non-thrift lending ratio represents one possible upper boundary for the non-QTL lending ratio. In this respect, tracking both ratios is simply prudent business practice, entirely consistent with the System's tradition of conservative financial management.

Second, even if both ratios are consistently and accurately measured, it is not possible to project them with any certainty. At the FHLB of Boston, we have simply extrapolated the recent trend in the non-thrift lending ratio. We find that this ratio could exceed 30% by late 1995. We consider that perfectly reasonable given:

- that commercial banks now hold more residential mortgage assets than savings institutions;
- that commercial banks are the fastest growing segment of the Bank System's membership; and
- the propensity of these new members to borrow advances.

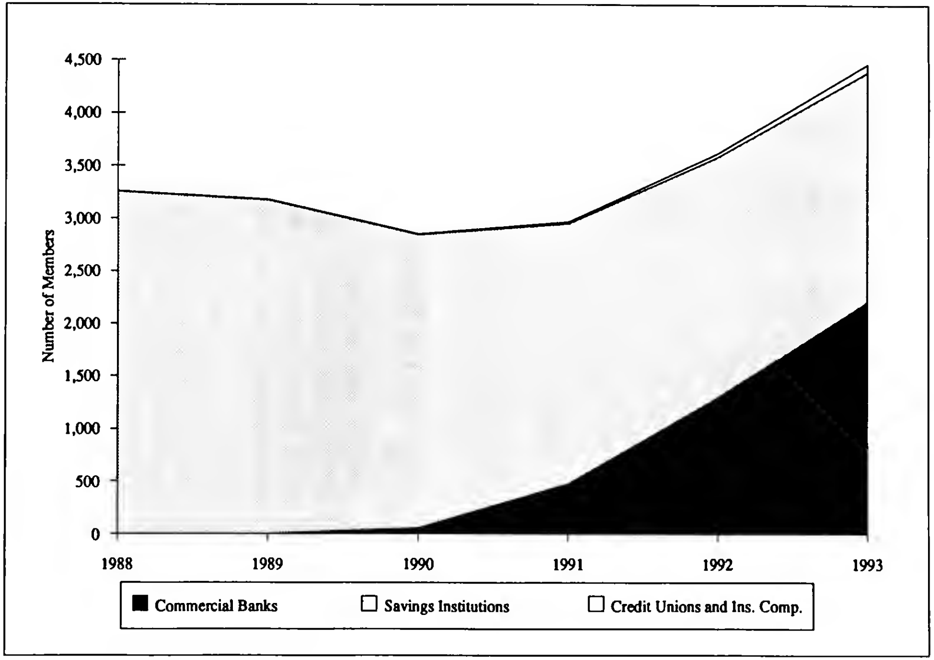
However, that does not preclude the ratio from crossing the 30% threshold earlier or later. There are just too many factors--none of which the Bank System controls--that influence those ratios. The very existence of a lending cap in the face of such uncertainties is what causes us the most concern.

The modest change proposed by the Baker amendment provides additional lending capacity to the System while more comprehensive legislation is being considered. Indeed, it is difficult to understand how the System and its shareholders would benefit from being forced into an arbitrary credit allocation which is totally unrelated to the housing finance activities of its members.

ATTACHMENT A

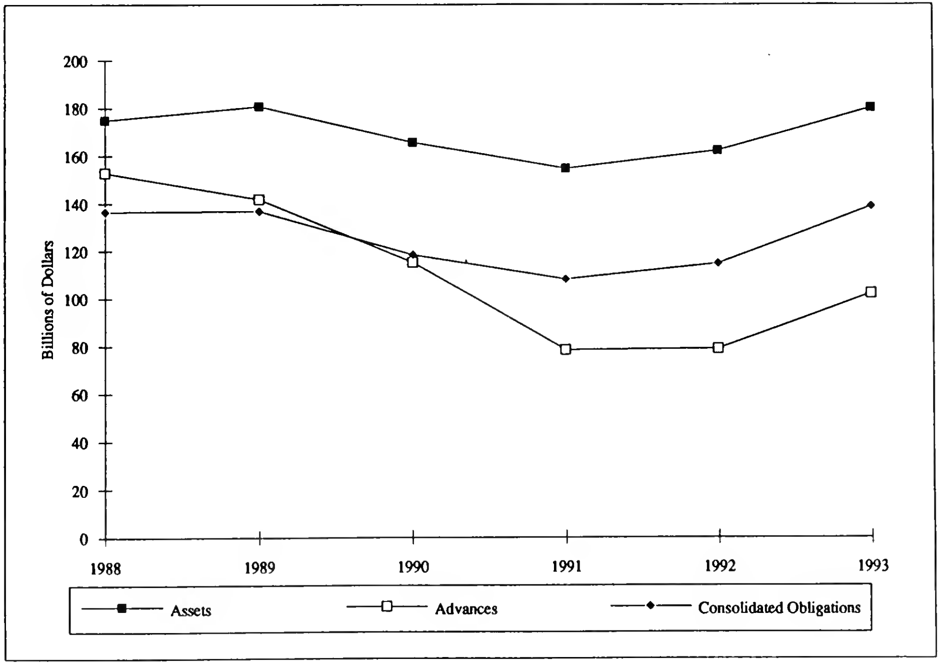
GRAPHS AND TABLES DEPICTING THE POSITIVE FINANCIAL TRENDS AND CONTRIBUTION TO AFFORDABLE HOUSING AND COMMUNITY DEVELOPMENT OF THE BANK SYSTEM AND THE FHLB OF BOSTON IN THE POST-FIRREA ERA

MEMBERSHIP HAS INCREASED 50% SINCE THE POST-FIRREA DIP WITH AN INFLUX OF NEW COMMERCIAL BANK MEMBERS



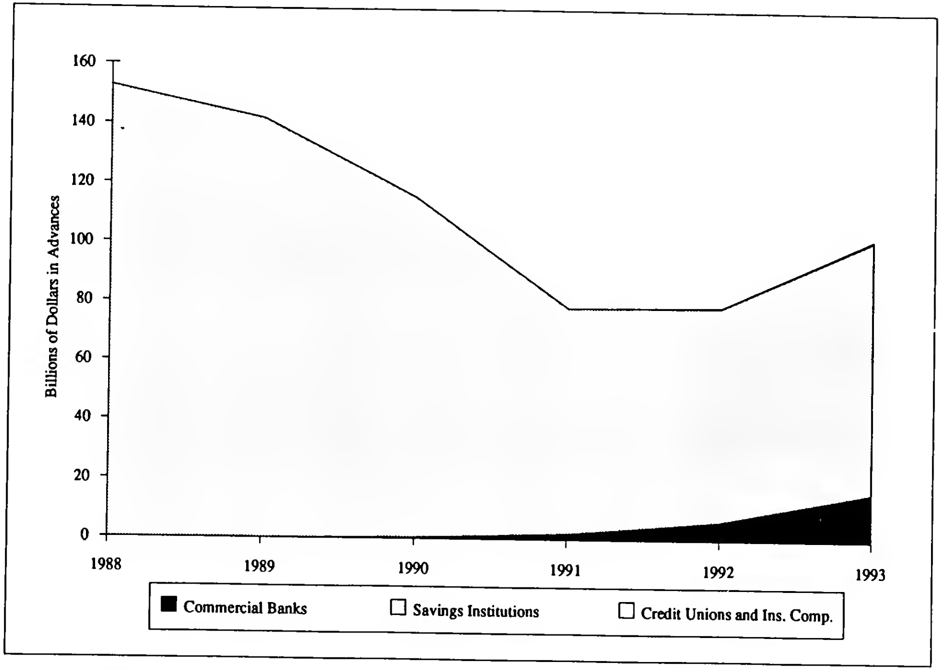
Source: Federal Housing Finance Board

**DRIVEN BY THE DEMAND FOR ADVANCES,
THE BANK SYSTEM'S ASSETS AND CONSOLIDATED OBLIGATIONS
HAVE STEADILY INCREASED SINCE YEAR-END 1991**



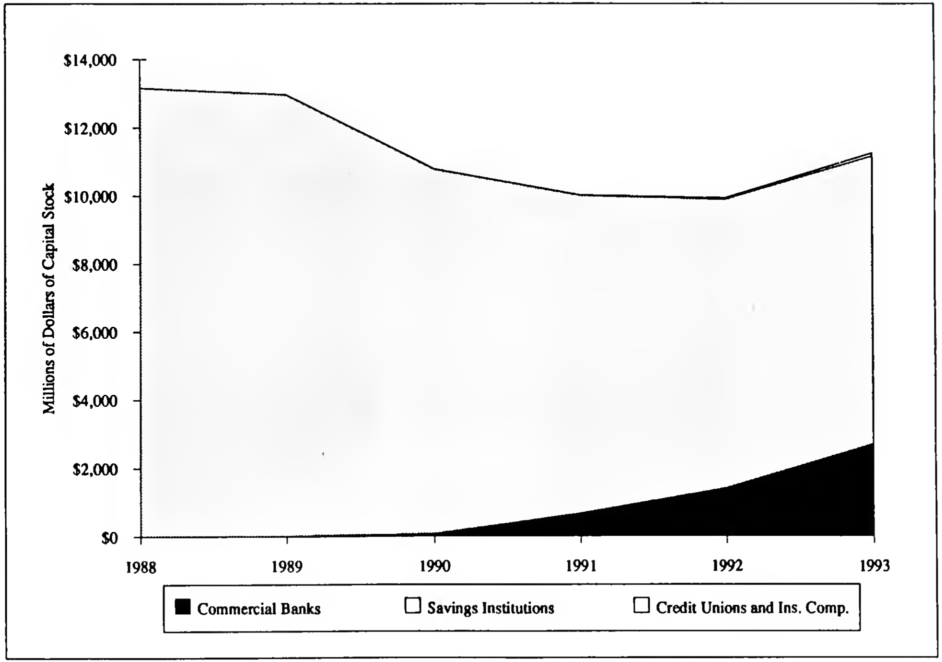
Source: Federal Housing Finance Board

ADVANCES TO NEW COMMERCIAL BANK MEMBERS HAVE BEEN A SIGNIFICANT FACTOR IN OVERALL ADVANCE GROWTH



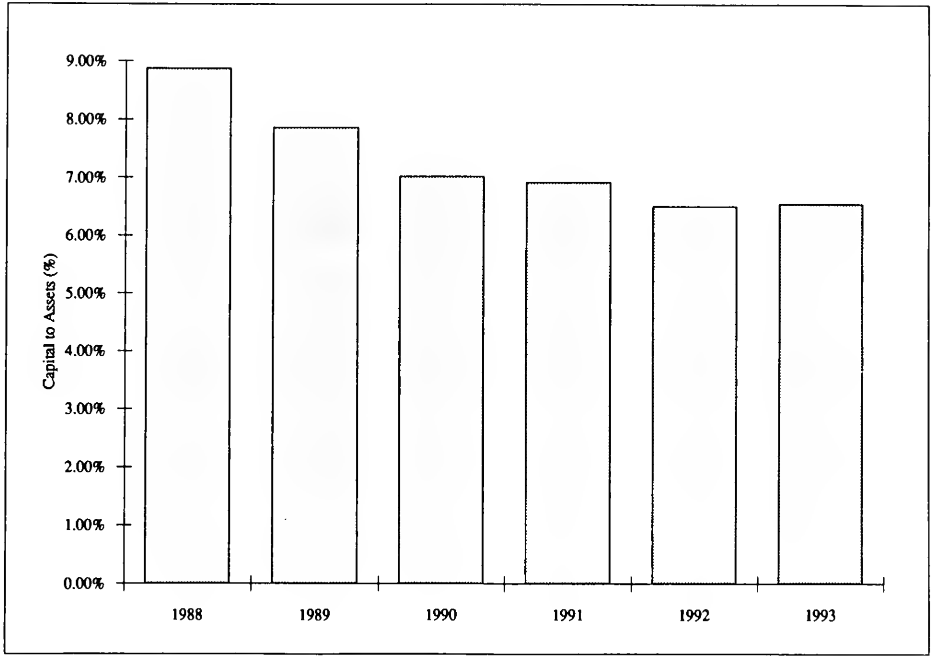
Source: Federal Housing Finance Board

CAPITAL STOCK HELD BY MEMBERS ALSO HAS INCREASED, WITH COMMERCIAL BANKS HOLDING 25% OF THE TOTAL



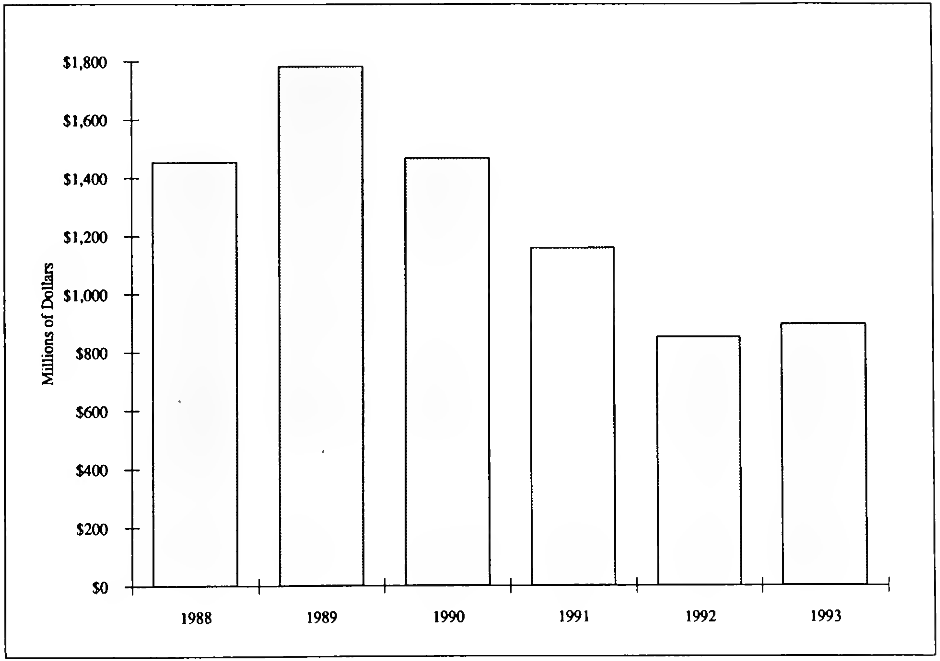
Source: Federal Housing Finance Board

BY VIRTUE OF ITS MEMBER-OWNED CAPITAL STOCK, THE BANK SYSTEM MAINTAINS A HEALTHY CAPITAL-TO-ASSET RATIO



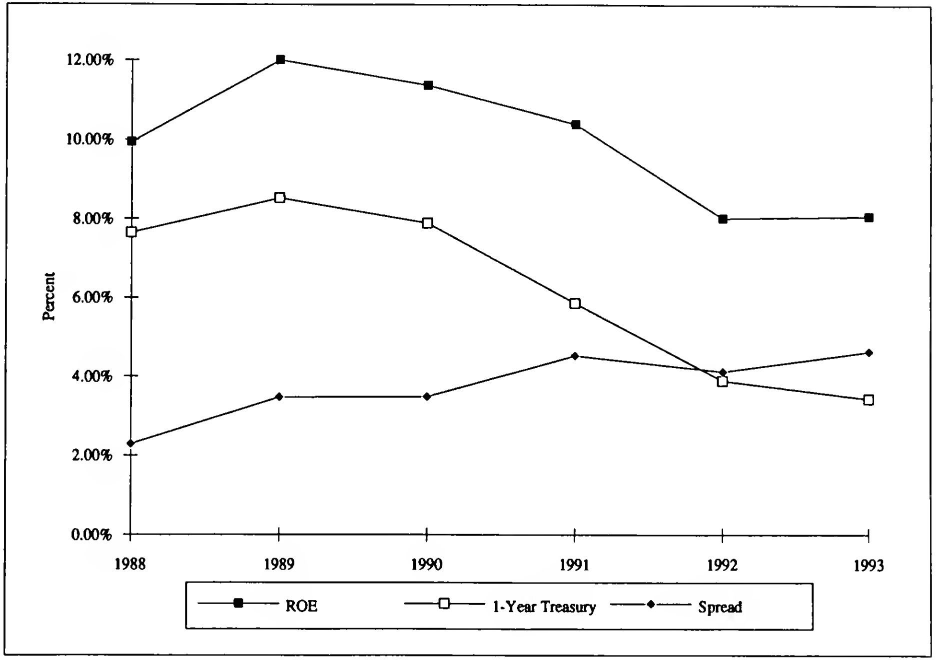
Source: Federal Housing Finance Board

THE BANK SYSTEM'S NET INCOME IS DOWN FROM PRE-FIRREA PEAKS, BUT EARNINGS DID INCREASE IN 1993 FOR THE FIRST TIME IN THREE YEARS



Source: Federal Housing Finance Board

DESPITE VARIANCE IN DOLLAR EARNINGS, THE SYSTEM'S RETURN ON EQUITY HAS MAINTAINED A HEALTHY SPREAD TO MARKET YIELDS



Source: Federal Housing Finance Board

MEMBERSHIP COMPOSITION OF THE FHLB OF BOSTON

Number of Members at End of Period	March 1994	1993	1992	1991	1990	1989	1988
Mandatory thrift members	71	75	77	81	91	95	96
Voluntary thrift members	206	205	187	196	208	219	219
Total thrift members	277	280	264	277	299	314	315
Commercial bank members	79	77	65	47	5	0	0
Credit union members	16	15	10	4	0	0	0
Insurance company members	1	0	0	0	0	0	0
Total non-thrift members	96	92	75	51	5	0	0
Total members	373	372	339	328	304	314	315
Memo items:							
Voluntary members	302	297	262	247	213	219	219
Percent of all members	81%	80%	77%	75%	70%	70%	70%
Percent of capital stock held by voluntary members	84%	83%	80%	80%	74%	70%	68%

FINANCIAL HIGHLIGHTS OF THE FHLB OF BOSTON

Dollars in Thousands	March/ 1st Quarter 1994	1993	1992	1991	1990	1989	1988
Selected Items at Period End							
Total Assets	$13,693,408	$13,916,362	$11,705,654	$10,602,908	$11,011,794	$11,636,088	$11,961,448
Total Investments	$6,745,826	$6,426,032	$6,549,735	$5,050,774	$2,030,170	$1,334,881	$920,448
Mortgage Backed Securities	$2,141,044	$1,764,555	$1,663,610	$1,110,644	$0	$0	$0
Advances	$6,731,119	$7,207,840	$5,037,560	$5,296,927	$8,792,981	$10,150,041	$10,894,929
Deposits	$1,443,680	$1,576,439	$1,769,051	$1,978,098	$2,279,452	$1,597,867	$1,031,886
Consolidated Obligations	$10,997,373	$11,148,501	$8,772,870	$7,686,813	$7,716,711	$8,887,143	$9,789,215
Capital Stock	$921,190	$871,831	$770,647	$769,240	$840,488	$872,271	$841,839
Retained Earnings	$51,197	$55,031	$72,465	$37,756	$19,170	$88,269	$111,117
Total Capital	$972,386	$926,862	$843,112	$806,996	$859,658	$960,540	$952,956
Average Yields or Costs							
Interest Yield of Assets	4.70%	4.94%	5.17%	7.43%	8.69%	9.20%	8.31%
Cost of Funds Including Capital	4.09%	4.30%	4.57%	6.58%	7.64%	8.02%	7.28%
Yield/Cost Spread	0.61%	0.64%	0.60%	0.85%	1.05%	1.18%	1.03%
Operating Results							
Net Interest Income	$19,314	$74,193	$65,927	$86,870	$120,031	$139,709	$118,121
Net Income	$14,866	$57,392	$52,443	$88,205	$103,402	$120,335	$107,393
Return on Average Equity	6.32%	6.46%	6.35%	10.91%	11.33%	12.36%	11.80%
Return on Average Assets	0.47%	0.50%	0.48%	0.83%	0.90%	0.99%	0.94%
Average Capital to Average Assets	7.43%	7.70%	7.51%	7.58%	7.95%	8.02%	7.99%
Administrative Expenses as a Percentage of Average Assets	0.09%	0.10%	0.12%	0.14%	0.12%	0.12%	0.12%
Dividend Rate	7.00%	7.58%	7.85%	9.00%	9.62%	11.84%	10.63%

SUMMARY OF THE AFFORDABLE HOUSING PROGRAM 1990-1993

Dollars in Millions	FHLB of Boston	Systemwide
Projects Funded	102	1,790
Total Subsidy Awarded	$18.2	$233.9
Units Funded	3,217	62,425
% for Ownership	24%	30%
% for Very-Low Income	70%	64%
AHP Subsidy Per Unit (Actual Dollars)	$5,672	$3,748
Total Development Costs	$218.5	$3,177.4

SUMMARY OF THE COMMUNITY INVESTMENT PROGRAM AND THE NEW ENGLAND FUND 1990-1993

	FHLB of Boston		Systemwide
Dollars in Millions	CIP	NEF	CIP
Advances Disbursed	$367.3	$106.5	$4,533.5
Units Funded	6,638	1,021	122,600
% for Ownership	63%	63%	72%
Number of Economic Development Projects Funded	4	5	136

ATTACHMENT B

SYSTEM 2000 OVERVIEW AND IMPLEMENTATION UPDATE AS OF MARCH 29, 1994

SYSTEM 2000 IMPLEMENTATION UPDATE

In September 1993, the Federal Home Loan Bank System announced the completion of the development phase of "System 2000: A Strategic Framework for the Future of the Federal Home Loan Bank System." The boards of the System's 12 regional banks and their regulator, the Federal Housing Finance Board have endorsed System 2000 as an adaptable framework for developing a Systemwide strategic plan.

Central to System 2000 is this statement of the System's purpose:

> The mission of the Federal Home Loan Bank System is to facilitate the extension of credit through its members in order to provide access to housing for all Americans and to improve the quality of their communities.

According to System 2000, this mission is to be accomplished consistent with the System's vision and values, to wit:

> Integral to the Bank System's mission is its vision of expanding opportunities for members to address affordable housing finance and neighborhood development needs at the local community level. The Bank System should determine how it can expand those opportunities within safety and soundness standards and other appropriate risk and performance parameters, particularly maintenance of the Bank System's stand-alone AAA-rating.
>
> The values of the Bank System require it to fulfill its mission by supporting its membership through wholesale banking activities, including serving as a source of short-, medium- and long-term liquidity, making advances for housing and neighborhood development purposes, and providing other support services that facilitate portfolio lending by its members.
>
> In assessing how the Bank System fulfills its mission, the Bank System should be fair to its members by not capitalizing on its agency status to the competitive detriment of its members. The Bank System should be operated in a safe and sound manner, so as not to endanger the taxpayer or the capital investment of its stockholders. Finally, in order to attract and maintain a viable membership base, the Bank System should provide real economic value to its stockholders/members as measured by the benefits of membership and an acceptable rate of return on its stockholders' capital investment.

These statements of the System's mission, vision and values codify the Bank System's long-standing public policy purpose. This mission is as relevant today as it was when the System was created 62 years ago. While the delivery systems for mortgage credit have become more efficient for households conforming to certain pre-established criteria, the nation's greatest challenge is to provide safe, decent and affordable housing for those Americans with profiles that do not fit within those pre-established criteria.

These important segments of society include working class families, the disabled, minorities and others that have traditionally had less access to low-cost mortgage credit. The challenge for the Bank System is to assess how it can safely, soundly, and economically enhance its members' ability to meet the housing and other credit needs of all segments of the communities they serve.

During the implementation phase of System 2000, Bank System staff are preparing work plans to carry out seven goals aimed at furthering the System's mission. The boards of directors of the 12 Banks ultimately are responsible for reviewing, approving and monitoring implementation of these work plans. By the end of the first quarter of 1994, the Bank System had made significant progress on all seven goals:

<u>Goal #1: Enhance the Bank System's Image and Increase Customer Utilization of the Bank System's Credit Products</u> -- A detailed work plan completed in December 1993 is under review by the boards of the 12 Banks. It includes a national communications program, a business development program, and a regulatory outreach effort. Combined with the work on Goals #2 and #3, these efforts will help increase the System's level of advances to its growing customer base of more than 4,500 commercial bank, savings institution, credit union and insurance company shareholders. Advances are the primary vehicle through which the System fulfills its mission.

<u>Goal #2: Expand the Line of Financial Products for Members</u> -- A committee of Bank System officers has developed an evaluation framework for new products and services that would benefit from Systemwide review. This committee also is proposing a more effective inter-Bank communications network to speed exchange of information about product innovations throughout the System. The Bank Presidents will review this draft plan in April 1994. Consideration by the boards of directors will follow in May or June.

<u>Goal #3: Expand the Line of Products that Support Affordable Housing Finance and Neighborhood Development Activities of Members</u> -- A work plan was completed in February 1994 and is under review by the regional boards. The plan will support and enhance member involvement in their communities; broaden and depend the effect of the System's Affordable Housing and Community Investment Programs; and identify gaps in affordable housing and community investment financing and assess how the Banks, through their members, can help address such needs.

<u>Goal #4: Develop a Comprehensive Financial Management Policy, Capital Structure and Financial Model for the Bank System</u> -- Work on this goal has ranged from analyzing improvements in the Finance Board's policy governing the Banks' investment authorities--some of which were adopted by the Finance Board in December 1993--to projecting the System's financial performance and modeling alternative capital structures. This goal will be critical to the debate on the System's structure and role that will ensue when a series of Congressionally mandated studies of the Bank System is complete.

Goal #5: Clarify the Relationship Between the Finance Board and the Bank Boards -- There is broad agreement both inside and outside the Bank System that it is inappropriate and unnecessary for the Finance Board to be responsible for both regulating and governing the 12 Banks. It is in the System's and the public's best interests to statutorily separate these duties, with all governance responsibilities eventually residing with the regional boards. To implement Goal #5, the statutory division of responsibilities between the Finance Board and the Bank boards has been carefully delineated. In addition, a select group of shareholders, public interest representatives, and Bank Presidents has debated the merits of creating a central coordinating body for the 12 Banks. This debate led to the establishment of a 36-member Governmental Affairs Committee to coordinate legislative positions and lobbying efforts for the System. This committee is having an organizational meeting in early April.

Goal #6: Continue to Improve Systemwide Operating Efficiencies -- The 12 Banks are highly efficient operations, with operating expense ratios far below other wholesale banks. So the System may continue to function efficiently, a Systemwide committee is assessing potential cost savings in 28 functional areas. In April 1994, the Bank Presidents will consider the committee's recommendations and establish a list of priorities for action by the regional boards.

Goal #7: Identify a Legislative Agenda To Be Pursued by the Bank System -- Work on this goal is pending the formal establishment of the Governmental Affairs Committee mentioned under Goal #5. A legislative agenda for the System will be developed once this committee is functioning and the conclusions of all the Congressionally mandated studies of the Bank System are known.

The Bank System is a safe and strong enterprise that has played an important role in the provision of credit for housing in the United States for more than 60 years. No one has a better appreciation of how the System can improve and enhance that mission than the Banks and their shareholders. Through the implementation of System 2000, the Bank System will continue to play a vital role in meeting the nation's housing finance and community development needs well into the 21st century.

March 29, 1994

ATTACHMENT C

FHLB OF BOSTON 1993 AFFORDABLE HOUSING PROGRAM PROJECT APPROVALS

FEDERAL HOME LOAN BANK OF BOSTON

1993 Affordable Housing Program Project Approvals

Connecticut

Member Institution	First Federal Bank, A Federal Savings Bank, Waterbury, Connecticut
Sponsors	Naugatuck Valley Housing Development Corporation
Description of Project	Chestnut Avenue Cooperative Total rehabilitation of 2 buildings to create 6 two-bedroom units for low- and very low-income households.
Location	Waterbury, Connecticut
Amount and Type of Subsidy	$36,000 direct grant
Number and Type of Units	6 co-operative ownership units
Special Features	Residents will own their homes through a co-operative They will contribute sweat-equity and take part in a training program to develop skills for co-operative ownership. All units will be affordable to families with incomes at or below 80% of median income for the area, and 3 units will be affordable to families with incomes at or below 50% of the median

Member Institution	People's Bank, Bridgeport, Connecticut
Sponsors	Mountain Valley Place, Inc
Description of Project	Mountain Valley Place Housing for the Elderly Construction of 41 units of housing for very low-income senior citizens
Location	New Haven, Connecticut
Amount and Type of Subsidy	$210,000 direct grant
Number and Type of Units	41 rental units
Special Features	Residents will be seniors 62 years of age and over with incomes at or below 50% of median income for the area The facility will consist of independent living units together with on-site management, laundry, and community-room facilities Three of the units will be wheelchair accessible

Member Institution	People's Bank, Bridgeport, Connecticut
Sponsors	Mutual Housing Association of Southwestern Connecticut
Description of Project	Trinity Park Acquisition and renovation of a vacant 48-unit, HUD-owned property to provide secure and permanently affordable family living in 2-, 3-, and 4-bedroom homes
Location	Stamford, Connecticut
Amount and Type of Subsidy	$210,000 direct grant and $875,000 15-year below-market-rate loan
Number and Type of Units	48 rental units
Special Features	Trinity Park will be developed and owned by a mutual housing association Tenants will participate in managing the project through membership in the association. 83% of the units will be for households with incomes at or below 50% of the area median 15% will be for families with incomes between 50% and 80% of median.

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Maine

Member Institution	Gardiner Savings Institution, FSB, Gardiner, Maine
Sponsors	Kennebec Valley CoHousing
Description of Project	Kennebec Valley CoHousing Construction of 16 homes within a 24-home co-operatively owned subdivision Attached homes in 2-4 unit clusters and single-family units will be sited in a village-like arrangement on less than 10% of the land 90% of the co-operative's parcel will be placed in conservation easements for agriculture and the preservation of forest
Location	Readfield, Maine
Amount and Type of Subsidy	$144,000 direct grant
Number and Type of Units	16 co-operative ownership units
Special Features	10 of the 16 AHP-assisted units will be affordable to households with incomes at or below 50% of median income for the area, and 6 will be affordable to households earning between 50% and 80% of the median Construction will include a substantial sweat-equity component

Member Institution	Kingfield Savings Bank, Kingfield, Maine
Sponsors	Western Mountain Community Land Trust
Description of Project	Porter Hill Community Construction and financing for 7 single-family homes on 2 sites 6 clustered homes associated with 42 acres to be held in common for conservation, and 1 home to replace an aging mobile unit on a second site owned by Western Mountain Community Land Trust
Location	Farmington, Maine (6 units) and North Anson, Maine (1 unit)
Amount and Type of Subsidy	$42,000 direct grant and $64,173 20-year advance
Number and Type of Units	7 owner-occupied homes
Special Features	All homes are for ownership by households with less than 50% of median income for the area To guarantee affordability to future low-income homeowners, home sites will be held by the land trust and leased to homeowners Energy-efficient and environmentally sensitive design features will reduce operating costs for these homes Owners will take part in the construction

Massachusetts

Member Institution	Boston Bank of Commerce, Boston, Massachusetts
Sponsors	Re-Vision House
Description of Project	Re-Vision House II. Rehabilitation of a multifamily building to house young mothers with infant children.
Location	Dorchester, Massachusetts
Amount and Type of Subsidy	$18,000 direct grant
Number and Type of Units	6 rental units
Special Features	Re-Vision House II will broaden the reach of the sponsor's existing program to provide supportive living for pregnant and parenting teenage women at risk of becoming homeless Young mothers will typically take part in the residential program for 9 months to 2 years Counseling, assessment and referral services, and 24-hour staff supervision will help develop a range of skills to facilitate ultimate transition to independent living

Member Institution	Boston Five Cents Savings Bank, FSB Boston, Massachusetts
Sponsors	Women's Institute for Housing and Economic Development
Description of Project	Perrin Street Apartments Gut renovation of an abandoned nursing home to create 14 2-bedroom apartments as permanent rental housing for families at risk of homelessness
Location	10 Perrin Street, Roxbury, Massachusetts
Amount and Type of Subsidy	$110,000 direct grant and $42,675 20-year advance
Number and Type of Units	14 rental apartments
Special Features	All units are for homeless households with incomes at or below 50% of median income for the area The project is structured with low debt service in order to operate without ongoing governmental rent subsidies The AHP-funded construction and development will create homes that will be linked to a social services program (not AHP funded) to develop skills for the economic self-sufficiency of residents

Member Institution	Brookline Savings Bank, Brookline, Massachusetts
Sponsors	Habitat for Humanity of Boston, Inc
Description of Project	Dale Street Construction to create 4 three-bedroom units within the shell of a building not completed by a prior development collaborative
Location	Roxbury, Massachusetts
Amount and Type of Subsidy	$24,000 direct grant
Number and Type of Units	4 ownership units
Special Features	Ownership will be available to families with incomes at or below 50% of median income for the area When identified by Habitat's selection committee, future owners will begin earning sweat-equity hours

Member Institution	Gloucester Bank & Trust Company, Gloucester, Massachuetts
Sponsors	Cape Ann YMCA
Description of Project	Cape Ann YMCA Community Center. Rehabilitation of an existing building to create affordable SRO units in a supportive living setting
Location	Gloucester, Massachusetts
Amount and Type of Subsidy	$100,000 direct grant
Number and Type of Units	22 rental units
Special Features	These 22 SRO units will be affordable to single, very low-income men with incomes at or below 50% of the median for the area Support services will be provided by a resident manager and an on-site social-service coordinator The units are located in the Pattillo Building, where renovations already completed include a senior center and retail space

Member Institution	Haverhill Co-operative Bank, Haverhill, Massachusetts
Sponsors	Presidential Gardens Neighborhood Association
Description of Project	Presidential Gardens Rehabilitation of 169 affordable rental units within a 200-unit complex to be acquired by the sponsor under HUD expiring-use provisions of the Low Income Housing Preservation and Residential Homeownership Act of 1990.
Location	Haverhill, Massachusetts
Amount and Type of Subsidy	$210,000 direct grant
Number and Type of Units	169 rental units
Special Features	The 169 units will be rehabilitated for continuing occupancy by current low- and very low-income residents, who will take part in management of the complex through membership in the tenants' association formed to acquire and manage the property

Member Institution	Heritage Co-operative Bank, Salem, Massachusetts
Sponsors	North Shore Association for Retarded Citizens
Description of Project	Specialized rehabilition to provide congregate-living units for 8 very-low income persons with physical and developmental disabilities.
Location	16 Hale Street, Beverly, Massachusetts
Amount and Type of Subsidy	$55,000 direct grant
Number and Type of Units	8 rental units
Special Features	The 8 AHP-funded units will house disabled individuals with incomes at or below 50% of median income for the area. Design features will maximize the independence of residents with cognitive and physical disabilities Situated within a larger historical dwelling, the project integrates congregate housing for the disabled with non-disabled households in 5 additional rental units (non-AHP)

Member Institution	Newburyport Five Cents Savings Bank Newburyport, Massachusetts
Sponsors	Salisbury Housing Authority
Description of Project	Assisted Living Center. Acquisition of a building and its conversion to SRO units for frail and disabled elderly under a supported residential living model
Location	35 Beach Road, Salisbury, Massachusetts
Amount and Type of Subsidy	$150,000 direct grant and $400,000 20-year advance
Number and Type of Units	28 single room occupancy rental units
Special Features	All residents will have incomes at or below 50% of median for the area The project will serve medically stable seniors, who will take part in decision making through an advisory group of tenant representatives.

Member Institution	North Cambridge Co-operative Bank, Cambridge, Massachusetts
Sponsors	RUAH, Breath of Life, Inc.
Description of Project	Acquisition and rehabilitation of a building to provide permanent supportive housing for homeless women with HIV infection and/or AIDS
Location	10 Russell Street, Cambridge, Massachusetts
Amount and Type of Subsidy	$45,500 direct grant
Number and Type of Units	7 single room occupancy rental units
Special Features	All units will be affordable to women with incomes at or below 50% of median income for the area Residents are to receive case-management and support services coordinated by 24-hour in-house staff and will participate in maintenance activities and decision making at the residence

Member Institution	Peoples Savings Bank, Worcester, Massachusetts
Sponsors	Oak Hill Community Development Corporation
Description of Project	Union Hill Rental Housing Initiative. Acquisition and rehabilitation of 5 distressed triple deckers to create permanently affordable rental housing for low- and very low-income families
Location	Worcester, Massachusetts
Amount and Type of Subsidy	$95,262 direct grant
Number and Type of Units	18 rental units
Special Features	9 units will be affordable to households with incomes at or below 80% of median income for the area, and 9 will be targeted to families earning at or below 50% of the median. On the same site, the sponsor is also developing one commercial office space for its own occupancy.

Member Institution	Salem Five Cents Savings Bank, Salem, Massachusetts
Sponsors	Lynn Economic Opportunity Council, Inc
Description of Project	LEO Affordable Apartments Rehabilitation of 2 multifamily buildings to provide 10 apartments, including 4 units with 3 or more bedrooms for very low-income families
Location	Lynn, Massachusetts
Amount and Type of Subsidy	$50,000 direct grant and $150,844 20-year below-market-rate loan
Number and Type of Units	10 rental units
Special Features	All units will be affordable to families with incomes at or below 50% or median income for the area. 3 apartments are targeted for homeless families. The sponsor will provide tenants with case-management services to develop housing, financial, and family stability

Member Institution	Savers Co-operative Bank, Southbridge, Massachusetts
Sponsors	South Middlesex Opportunity Council (SMOC) through its subsidiary, South Middlesex Non-Profit Housing Corporation
Description of Project	Northbridge Neighborhood Revitalization Project Acquisition and rehabilitation of 19 buildings, including 13 now held by the FDIC, to restore the usefulness of deteriorated buildings currently less than 30% occupied
Location	Northbridge, Massachusetts
Amount and Type of Subsidy	$210,000 direct grant
Number and Type of Units	100 rental units
Special Features	50 of the units will be affordable to households with incomes at or below 50% of median for the area, with 25 reserved for the homeless 50 units will be affordable to households with incomes between 50% and 60% of the median. 59 will be family units, and 4 will be designed for full accessibility by physically disabled persons. An entire neighborhood will benefit through stabilized tenancies, preservation of below-market rents, and elimination of current health and safety code violations in a significant number of buildings.

Member Institution	Shawmut Bank, N.A , Boston, Massachusetts
Sponsors	Rogerson House
Description of Project	Peter Faneuil House. Rehabilitation of a school building to create 40 units of SRO housing together with 8 family-housing units in 2- and 3-bedroom configurations
Location	Boston, Massachusetts
Amount and Type of Subsidy	$210,000 direct grant
Number and Type of Units	48 rental units
Special Features	All units will be affordable to households with incomes at or below 80% of the area median, with 32 of the SRO units for individuals with incomes at or below 50% of median Six units are to provide permanent residence for previously homeless persons.

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Member Institution	Shawmut Bank, N A , Boston, Massachusetts
Sponsors	Nuevo Esperanza, Inc
Description of Project	South Canal Apartments Acquisition and rehabilitation of rental units including 1-,2-,3-,4-, and 5- bedroom units for family occupancy
Location	Holyoke, Massachusetts
Amount and Type of Subsidy	$210,000 direct grant
Number and Type of Units	127 rental units
Special Features	Half of the units will be affordable to families with incomes at or below 80% of median income for the area, and half will be affordable to families with incomes at or below 50% of the median

Member Institution	Shawmut Bank, N A , Boston, Massachusetts
Sponsors	Madison Park Development Corporation
Description of Project	Haynes House Rehabilitation and modernization of an existing housing complex to sustain continuing affordability
Location	Roxbury, Massachusetts
Amount and Type of Subsidy	$210,000 direct grant
Number and Type of Units	113 rental units
Special Features	Capital improvements include upgrade of elevators and handicap accessibility, security improvements, modernization of kitchens and baths, and energy and water conservation systems to help sustain continuing affordability All units will be affordable to households with incomes at or below 80% of median income for the area, with 68 units for households with incomes at or below 50% of the median

Member Institution	Springfield Institution for Savings, Springfield, Massachusetts
Sponsors	Allen Park Tenants Association (APTA)
Description of Project	Allen Park Apartments Acquisition by tenants and rehabilitation of a 264-unit garden apartment complex The purchase prevents the dislocation of low- and very low-income tenants and preserves the affordability of a HUD-assisted "expiring use restriction" (EUR) complex
Location	Allen Park Road, Springfield, Massachusetts
Amount and Type of Subsidy	$210,000 direct grant
Number and Type of Units	208 rental units
Special Features	The AHP-funded units are occupied by 108 households with incomes below 50% of median for the area and 100 households with incomes between 50% and 80% of the median. Residents will control the complex through participation in APTA, a nonprofit corporation formed to acquire and manage the complex as affordable residences

Member Institution	United Co-operative Bank, West Springfield, Massachusetts
Sponsors	Springfield Action Commission, Inc
Description of Project	The Roinville Hotel Rehabilitation of a deteriorated and largely vacant single room occupancy building to provide 44 efficiency rental units as permanent rental housing for homeless individuals
Location	32 Byers Street, Springfield, Massachusetts
Amount and Type of Subsidy	$175,000 direct grant
Number and Type of Units	44 rental units
Special Features	All units are designated for homeless individuals with incomes at or below 50% of median income for the area. 3 units and all common areas will be fully accessible to physically disabled persons Social services will be provided both on site and through a referral network of area nonprofits

Member Institution	Warren Five Cents Savings Bank, Peabody, Massachusetts
Sponsors	The Community Builders, Inc.
Description of Project	Standpipe Hill Cooperative Housing Construction and permanent financing for 40 units in 7 new buildings on a 9-acre site
Location	Manchester-by-the-Sea, Massachusetts
Amount and Type of Subsidy	$210,000 direct grant and $204,170 20-year advance
Number and Type of Units	40 ownership units
Special Features	Half of the units will be affordable to households with incomes at or below 50% of median for the Salem-Gloucester PMSA 10 additional units will be for households at or below 60% of the median, and remaining units will be available to households with incomes below 80% of the median. The limited equity ownership structure will preserve affordability for future owners The 15 2-bedroom and 25 3-bedroom homes are scaled for family occupancy 2 units will be fully accessible to persons with physical handicaps.

New Hampshire

Member Institution	First NH Bank, Manchester, New Hampshire
Sponsors	Manchester Neighborhood Housing Services, Inc.
Description of Project	Merrimack Place. Conversion of an existing building to create 2 three-bedroom townhouses and demolition of blighted housing to allow construction of 14 additional 3-bedroom townhouses for low- and very low-income families.
Location	Manchester, New Hampshire
Amount and Type of Subsidy	$77,000 direct grant
Number and Type of Units	16 co-operative ownership units
Special Features	Residents will have ownership interest through a limited-equity co-operative. The sponsor will provide an intensive ownership counseling program in family budgeting, financial management, career development, and related areas. The units will be affordable to families with incomes below 60% of median income for the area, with 8 units for households earning less than 50% of the median.

Member Institution	Granite Bank, Keene, New Hampshire
Sponsors	Cheshire Housing Trust (CHT)
Description of Project	Marlborough Affordable Housing Project Acquisition and rehabilitation of several rental buildings to create 12 affordable rental units
Location	Multiple sites in Marlborough, New Hampshire
Amount and Type of Subsidy	$264,000 20-year advance
Number and Type of Units	12 rental units
Special Features	6 of the rehabilitated apartments will be affordable to households earning less than 50% of median income for the area, and 6 will be affordable to households with incomes between 50% and 80% of the median The rehabilitations will improve and preserve affordable housing opportunities in a community where many are currently overpaying for substandard homes Residents will be empowered through representation on CHT's board of trustees

Rhode Island

Member Institution	Citizens Savings Bank, Providence, Rhode Island
Sponsors	AS220
Description of Project	Empire Street Creation of 11 single-room residential studios for artists, with common kitchen, dining, and bath facilities, within a larger arts center to be developed by conversion of a blighted downtown building
Location	95-121 Empire Street, Providence, Rhode Island
Amount and Type of Subsidy	$65,000 direct grant
Number and Type of Units	11 single room occupancy rental units
Special Features	7 units will be for individuals with incomes below 50% of the area median, and 4 will be for individuals with incomes below 80% of the median The residential project will provide simple, safe, and affordable housing for very low- and low-income artists within a larger arts facility situated in an economic development area targeted by the Providence Redevelopment Agency

Vermont

Member Institution	Bank of Vermont, Burlington, Vermont
Sponsors	Burlington Community Land Trust
Description of Project	Housing for Homeless Acquisition and moderate rehabilitation of 3 historic buildings to create 27 single room occupancy units as permanent housing for homeless individuals.
Location	3 sites in Burlington,Vermont
Amount and Type of Subsidy	$145,000 direct grant and $622,740 20-year advance
Number and Type of Units	27 single room occupancy rental units
Special Features	All units will be for persons with incomes below 50% of the area median. The projects include 6 units for adults disabled due to mental illness, 9 units for homeless youths disabled due to mental illness or substance abuse, and 12 units for women Six units (2 at each site), as well as all ground-floor facilities (kitchen, bath, laundry, and living areas), are to be wheel-chair accessible Services will be coordinated by a resident manager at each site and provided through service-agency cosponsors and linked-service providers

DEAN SCHULTZ
PRESIDENT
FEDERAL HOME LOAN BANK OF SAN FRANCISCO
MAY 24, 1994

I. INTRODUCTION.

Mr. Chairman, Members of the Committee, I appreciate the opportunity to again appear before you to discuss the Federal Home Loan Bank System and the recently completed study of the System by the Department of Housing and Urban Department. A little over one year ago, we had the opportunity to discuss the challenges and opportunities facing the Federal Home Loan Bank System. At that time, we could only speculate at the direction of the policies of the new Administration. Today, with the HUD Study completed, the issues have been framed for a discussion of comprehensive reform of the system.

I am particularly pleased to appear here with my colleagues from some of the other Federal Home Loan Banks. As you will see today, although the Federal Home Loan Banks share common ground based upon their common charter, we all approach these issues from somewhat different perspectives. In the Bank System, just as everywhere else, where you stand is determined by where you sit. The priority that we in the Bank System each attach to specific issues is determined by the manner in which those issues impact our members and our communities.

The Administration has indicated its intention to prepare comprehensive legislation to submit to Congress addressing Federal Home Loan Bank issues. At the Federal Home Loan Bank of San Francisco, we believe that reform is imperative to increase the effectiveness of the system, and that reform must be comprehensive, not piece-meal, in nature. There are features of the current structure that harm housing by penalizing productive lending and rewarding passive investments. We believe that to reform the Federal Home Loan Bank System in a proper manner, one must understand the balance critical to the ongoing operation and success of the System. This balance has on the one side the Banks' business operations, and on the other the central social missions they currently perform, and the challenge is to understand and maintain the link between the financial performance of the Banks and their ability to achieve the public purposes set forth by Congress.

The Federal Home Loan Bank System has functioned well in the past because it has maintained this balance between meeting the legitimate expectations of its shareholders for a reasonable return on capital, and fulfilling the public policy mission as set out by the Congress. The System's shareholders have valued the System for the liquidity and lending functions it has performed, and for the dividend on their stock. The fact that they feel it adds value to their business enables the System to meet its public purpose. But that balance has been upset, and it could deteriorate further if changes are not made or if the wrong changes are made.

In addressing the specific recommendations made by HUD, I think that it is important to keep in mind the studies submitted by the other groups that Congress directed to analyze the Federal Home Loan Bank System. The studies prepared by the General Accounting Office and the Congressional Budget Office are particularly useful for measuring specific recommendations. That is not to say that we concur with all the findings of the GAO and CBO, because we do not, but these studies frame the issues impartially and completely.

II. RECOMMENDATIONS FROM HUD.

I will address the issues in the order that they are presented in the HUD study.

A. Functions of the Federal Home Loan Bank System.

SUPPORT OF PORTFOLIO LENDER

We applaud the HUD Study's recognition that "support to mortgage portfolio lenders should remain the core function of the Federal Home Loan Banks," as stated by Secretary Cisneros in his forward to the study.

An important economic competitive advantage and social strength of this country is its diversity. Having a system of community lenders who originate loans and hold them in their portfolios, and who operate according to local standards, has helped promote that diversity. Our shareholders have provided the opportunity of home ownership for many of those who do not fit within some definition of a "standard" borrower that is determined by Wall Street underwriting criteria.

The mission of the Federal Home Loan Banks is to support these community residential portfolio lenders. We support them by standing ready to lend billions of dollars on a moment's notice based on the security of home loans, whether or not such loans qualify for the secondary market. We are wholesale lenders, not retail lenders. Because we do not make loans to, or purchase loans from, consumers, our efforts in the communities of America can only be measured by the efforts of the financial institutions that are our members and owners.

SUPPORT THROUGH ADVANCES

One issue that has resurfaced in the HUD study is the question of whether there is actually a cause and effect link between Federal Home Loan Bank advances and specific mortgage loans made by our shareholders. This question raises the broader public policy issue of whether or not the Federal Home Loan Banks are efficiently performing a public function. Although we will have to try and answer the question as to cause and effect, I believe that effort spent trying to track advances is misplaced, and is not the only way to answer the public policy question. The real question is whether the System's owners, the regulated financial institutions, are doing what is desired. If they are not, the tools to address that problem are in the regulators' tool kits, not in the Federal Home Loan Banks' array of products. The Banks' serve the portfolio lenders, and help them perform their mission as it relates to residential finance. I think everyone would agree that the regulated financial institutions find value in the System. If that were not the case, there would not be over 2,200 commercial banks that have voluntarily bought stock in their district Federal Home Loan Banks. The narrower question of the causal relationship between outstanding advances and mortgage credit extended to individuals is based on a flawed premise: that only advances currently or previously extended affect the economic behavior of our members. It is not just the actual advances outstanding that

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affect the economic behavior of our shareholders; rather it is their authorized borrowing capacity for future advances that has the largest impact on their current and future economic behavior. A bank or thrift that has $1 billion of borrowing capacity at a Federal Home Loan Bank does not need to actually borrow that $1 billion to change its spending behavior; such a bank or thrift with access to advances will be more likely to invest its liquid funds in illiquid mortgage loans. If anyone doubts that this is true, think about the last time that you traveled: how much more currency would you have wanted in your wallet if you had not had a credit card available? Having access to credit has the same meaning for both people and financial institutions: they need to carry less liquidity. Access to Bank advances is a benefit for financial institutions because other investments, such as mortgage loans, carry higher returns than liquidity. It is also a benefit for society because financial institutions with such access are more willing to invest in longer-term assets that play an important part in the economic growth and stability of this country.

Mr. Chairman, I believe the Federal Home Loan Banks operate as an incentive for financial institutions to hold otherwise illiquid home mortgage loans that do not qualify for the secondary market. This benefits families of moderate income, families in the inner cities, and families who merit an opportunity for economic self improvement even if their particular financial ratios do not meet a standardized national target. Access to Federal Home Loan Bank advances gives lenders the confidence that they will be able to hold loans that they cannot sell at full value, and still meet either seasonal or cyclical demands from their depositors. In effect, access to Federal Home Loan Bank advances takes the liquidity risk out of lending to the families with the fewest financial options.

The purpose of Federal Home Loan Bank advances, as the CBO notes, is to provide their shareholders with a relatively inexpensive source of wholesale funds that is priced at a narrow mark-up over comparable U.S. Treasury bonds. One public policy question raised by several of the studies is how does this benefit of lower cost wholesale funds flow through to consumers? An analytical study prepared as a background policy paper for the HUD study asserts that lowering the cost of funds for Federal Home Loan Bank

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shareholders really does not have an aggregate impact on the availability of mortgage credit nationwide and only results in a redistribution of mortgages between members of the System and nonmembers. First, this analysis does not address the difference in the composition of the borrowers that receive funds from members and from non-members. Even if aggregate mortgage lending did not increase, it is possible to serve a public policy purpose by directing funds to communities that would otherwise be overlooked by the financial markets. As I elaborate later in my testimony, the members of our Bank are the dominant mortgage lenders in communities that receive little attention from California's other mortgage lenders. Second, and equally important, this analysis ignores the fact that roughly one-third of the adjustable-rate mortgages originated in the United States are indexed to the cost of funds of the shareholders of the Federal Home Loan Bank of San Francisco. Every decrease in our shareholders' cost of funds therefore decreases the mortgage interest rates for millions of homeowners all across the country. Federal Home Loan Bank advances, as a low-cost wholesale funding source, reduce the overall cost of funds of our shareholders, and that has the direct and immediate effect of lowering rates on home mortgage loans. Lower rates, of course, mean that more people of moderate income levels have access to home ownership. That is the fundamental purpose of federal housing policy.

MISSION STATEMENT

I concur in the succinct statement of purpose for the Federal Home Loan Bank System found on page 125 of the HUD study which reads as follows:

> The Federal Home Loan Bank System is a profit-making enterprise whose purpose is to support residential mortgage lending (including mortgages on housing for low- and moderate-income families), as well as community development lending, throughout the Nation, safely and soundly, primarily through a program of collateralized advances to System members. The System facilitates such lending by increasing the liquidity and improving the distribution of investment capital available through its member institutions.

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I think this mission statement reflects the balance between the profit-making nature of the System and its social mission, which can only be accomplished through, and by the actions of, its members.

REFCORP AND THE SYSTEM'S MISSION

Currently, the primary mission of the Federal Home Loan Banks is being distorted by the obligation to make interest payments on the bonds issued by the Resolution Funding Corporation ("REFCORP"), and by the manner in which those payments are allocated among the Federal Home Loan Banks. The Federal Home Loan Banks are required by law to make a fixed annual REFCORP payment of $300 million. As the GAO has noted, this fixed obligation has caused the Federal Home Loan Banks to greatly increase their investment portfolios, particularly their investments in mortgaged backed securities. The GAO's finding is that this investment "has increased both the interest rate risk and management risk in the System, thereby raising the possibility that meeting the fixed obligations could conflict with the System's safety and soundness." The GAO is correct.

The Federal Home Loan Banks continue to hold large investment portfolios and will soon have mortgage-backed security portfolios equal to three times their capital. Let there be no mistake about our position on this issue. We are not pleased to be in the business of investing in mortgage-backed securities, but the current drain on our funds is so significant we find ourselves with no choice if we want the System to continue to function. As the CBO has noted, without these investments, the System would be in financial trouble. We believe that after the System is reformed, the Federal Home Loan Banks should only hold short-term investments, and only enough of those investments to meet any temporary surge in demand for advances. The Federal Home Loan Banks should not invest in mortgage-backed securities. If System shareholders want to invest in mortgage-backed securities, they should do so directly, not indirectly through their ownership of Federal Home Loan Bank stock. But the only way that reform can be adopted is to reform the fixed nature of the REFCORP obligation.

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The other problem I wish to draw attention to with respect to the REFCORP payments is the allocation formula. The REFCORP payment is allocated in two steps: first, each Bank pays 20 percent of its net income, and second, to the extent that that aggregate amount does not equal $300 million, each Bank pays an additional amount based on its share of total System advances outstanding to savings associations insured by the SAIF. This allocation method is unrelated to a Bank's income, because so much income is derived from the investment portfolios. Instead, it burdens the type of asset which is the reason for the Banks' existence. San Francisco has a large share--the largest share--of advances to SAIF insured institutions. Most of the other Federal Home Loan Banks are, understandably, opposed to changing this allocation formula because most of the other Banks pay less because we pay more.

The GAO states that "The Shortfall Allocation Penalizes Lending and Could Disrupt the System," and the CBO concludes that the REFCORP payment "subverts" a Federal Home Loan Bank's incentive to make advances to savings and loans. Both the GAO and CBO conclude that the formula penalizes the Federal Home Loan Banks for fulfilling the purpose for which they were chartered: lending money to savings associations. Furthermore, the formula directly penalizes our advances under AHP and CIP. AHP and CIP loans are not exempted from the formula that increases each Federal Home Loan Bank's share of the REFCORP assessment for each dollar outstanding in loans to savings associations. If the shortfall allocation were simply an issue of geographic penalties, with California, Nevada and Arizona paying more so others could pay less, I do not think Congress would be moved to address this issue. But this issue cuts across state lines. As the HUD study noted, our members make loans nationwide, including AHP loans. The allocation formula also has long term adverse consequences for economic development of the other states.

B. Program Options.

FEDERAL HOME LOAN BANKS DO NOT REGULATE

Before I begin my analysis of HUD's recommendations on what it calls "program options," let me indicate my general discomfort with that term. I suggest that we need to think of these issues and frame them in terms of business opportunities and social

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responsibilities. Programs are something that a government regulator administers through its regulatory power. As you know, Congress established the Banks to perform a social mission as a provider of liquidity to promote housing finance, but due to the Banks' nature as a financial intermediary, this social mission can only be accomplished if the Banks operate their business successfully and profitably. In other words, we cannot force our customers to take a loan from us. We do not operate by regulatory edict; we operate by providing financial incentives to our members. We share your philosophy, Mr. Chairman, that the best means of bringing economic development to communities is through the creation of incentives to promote socially responsible economic behavior.

ADVANCE TARGETING

I am concerned by HUD's recommendation that an "additional mechanism" be created to require the commercial banks and thrifts that borrow funds from a Federal Home Loan Bank to use a specified portion of those advances for housing for low- and moderate-income families. The HUD report suggests that specific collateral targets would have to be met, and a new reporting system established. Mr. Chairman, that sounds like a regulator that wants to design a stick, not a carrot. I have just outlined how the REFCORP payment acts as a significant disincentive to make productive loans; further disincentives, or worse yet, goals that are transformed into limits on lending, would be counterproductive.

There is no need for additional legislation on this front. One problem with HUD's proposal is that it would not be an effective incentive for the behavior that HUD wants to motivate. One of the primary benefits of being a member of the Federal Home Loan Bank System is having the borrowing capacity that membership brings, whether or not any advances are outstanding at any particular moment. The Federal Home Loan Bank Act already provides that an institution may not join the Federal Home Loan Bank System unless its management and policies are consistent with safe home lending practices. 12 U.S.C § 1424. Further, certain community support requirements must be met in order for members to have access to long term loans from a Federal Home Loan Bank. 12 U.S.C. § 1430(g). To the extent that the underlying Community Reinvestment Act

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requirements are reformed or modified by the Administration and the federal banking and thrift regulators, the members of the Federal Home Loan Bank of San Francisco also will be required to satisfy those criteria. The point is that lenders' behavior should be addressed directly: our role is to support the portfolio lenders, not to direct their activities.

Another point needs to be made with respect to the proposal of targeting advances through restrictions on collateral or other means. These proposals would only result in larger mortgage-backed securities portfolios. The System now has the MBS portfolios in order to increase earnings so that the $300 million REFCORP payment, the $100 million AHP payment, Bank operating expenses, and FHFB assessments can be paid, and still leave enough earnings to pay a reasonable dividend. Dividend levels now are reasonable, but do not leave room for much reduction. If restrictions were placed on the use of advances, advance volume would not be likely to increase. It would, though, be likely to decrease. If it decreased, the System would have no choice but to increase mortgage-backed securities investments or undertake other investment activities even less related to its mission. The Banks cannot control the borrowing habits of their customers.

DIRECT LENDING

The HUD study concludes that no public policy objective would be served by allowing the Federal Home Loan Banks to make direct loans for housing construction. We agree with that conclusion. It is far better that we support our members who are active and experienced in such markets. As the background study prepared for HUD indicates, the Federal Home Loan Banks can accept home construction loans as collateral up to a certain limit, and the evidence suggests that limit is not constraining the construction lending of Federal Home Loan Bank members.

SHAREHOLDER ACTIVITIES

So far, my remarks have been confined to economic theory and public policy issues. I have talked about the benefit to financial institutions in holding illiquid loans supported by Federal Home Loan Bank advances. Let me briefly demonstrate how the

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shareholders of the Federal Home Loan Bank extend that benefit to the real world.

South Central Los Angeles is a community with well-known social and economic problems. The financial institutions that are members of the Federal Home Loan Bank of San Francisco are the most significant source of residential lending in South Central Los Angeles. Overall, our members make 39 percent of the mortgage loans in California; but in the low-income areas of South Central Los Angeles[1], FHLB shareholders make 65 percent of the mortgage loans. Our members made loans of $895 million in South Central Los Angeles in 1992, of which $726 million went to minority applicants. The statistics pertaining to South Central Los Angeles are not an aberration; the percent of mortgage dollars invested in low-income community mortgage loans by our members is 50 percent greater than that of other financial institutions and mortgage originators in California. This lending occurs because it is good business, and it is supported by the regular advances program as well as the targeted programs.

The other link the Federal Home Loan Banks provide between the financial community and the low-income neighborhoods of this nation are the targeted Affordable Housing Program and the Community Investment Program. One of the analytical studies prepared for the HUD report derides the AHP and CIP as "minuscule" relative to the housing programs of other national organizations. Mr. Chairman, I think that is an unwarranted criticism. These lending businesses have been started from a zero base less than 5 years ago. The contribution of the Federal Home Loan Banks to the Affordable Housing Program will increase another $25 million this year to $100 million per year.

TARGETED PROGRAMS

The Affordable Housing Program and the Community Investment Program are effective, targeted means of supporting the development of low-income communities.

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[1] Low-income area means a census tract in South Central Los Angeles with median family income less than 80% of the MSA median income for 1991.

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The Affordable Housing Program provides Federal Home Loan Bank members with below-market-rate loans or direct subsidies to finance the construction or rehabilitation of projects to meet the needs of low-income communities. Through December 1993, the Banks have provided about $234 million in affordable housing subsidies since the program was initiated, creating over 62,000 units of affordable housing. The rate of contribution gong forward is a minimum of $100 million per year.

Advances under the CIP are made at a discount from the Banks' regular advances. These loans are priced to just cover direct costs; so the Banks do not quite break even on the loans when indirect costs are added in. If the CIP advance is made to a SAIF-insured institution, the Banks actually lose money in that REFCORP taxes are not calculated as a direct expense. The purpose of this program is to encourage member institutions to make special efforts to increase their involvement in community revitalization and development. CIP advances may be used to support financing the construction, rehabilitation, or acquisition of residential or commercial property that benefits low- and moderate-income areas or families. Over $5 billion in subsidized advances had been made under this program through March 31, 1994, funding over 137,000 housing units and $170 million in economic development projects. Again, I would like to emphasize that our share of the REFCORP assessment increases each time we make an AHP or CIP loan to a savings and loan in our district.

I would like to contrast these programs to the requirements for the other housing GSEs. FNMA and FHLMC have requirements to acquire loans made to families of moderate income, but federal law states that they must earn a reasonable return on such investments. The Federal Home Loan Banks, on the other hand, are housing GSEs required by law to subsidize loans; that is, the Banks must make these loans at a loss. Furthermore, these loans are not made to families of moderate income. AHP loans are targeted at the lower end of the income scale.

These targeted segments of our business have received nearly universal acclaim from the local communities that have been served because they are flexible, non-bureaucratic ways to demonstrably improve the lives of people in the community. The staff at our

Bank works hard to promote partnerships between non-profits and mainstream financial institutions.

The Community Investment Program has been used to support mostly housing activity. That is because most of our borrowers are specialized housing lenders. They do not do a lot of business lending. But our members that do engage in small business lending find the CIP program to be very helpful. East-West Federal Bank received a $4 million CIP advance in 1993 to support the permanent financing for a small shopping center in Los Angeles' Chinatown district. Mr Chairman, you know from your experience that such retail facilities provide job opportunities and services to low income communities. That particular community has a median income that is 44% of the area median income. The shopping center not only provides economic opportunity, it helps maintain the area as a focal point of the local community. To the extent we can encourage institutions that have the expertise in making these types of loans to join the System, we can expand these types of economic opportunities.

C. Membership Requirements and Terms of Access for Advances.

The membership requirements of the Federal Home Loan Bank Act are a product of history, and a result of a compromise between the House and Senate in the FIRREA legislation passed in 1989. Prior to 1989, commercial banks and credit unions were not allowed to become members of a Federal Home Loan Bank. When FIRREA was adopted, Congress recognized the changing nature of the home mortgage lending industry, as commercial banks and credit unions began increasing their share of the home mortgage lending business. The Senate proposed letting commercial banks and credit unions join the System if they satisfied the same Qualified Thrift Lender, or QTL, test that applies to savings and loans; the House proposed letting all commercial banks and credit unions join. A compromise was reached whereby commercial banks and credit unions could join if they had at least 10% of their assets in mortgage loans, but lending was restricted so that no Federal Home Loan Bank could lend more than 30% of its advances to institutions that did not satisfy the QTL test. In the Housing and Community Development Act of 1992, that restriction on lending was further liberalized to permit an individual Federal Home Loan Bank to exceed the limit of 30% of

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loans to institutions that did not pass the QTL test, so long as the System as a whole did not exceed the 30% limit.

Institutions that are federally chartered savings associations are required by the Home Owners' Loan Act to belong to a Federal Home Loan Bank. 12 U.S.C. § 1464(f). Institutions that are state chartered savings associations currently are required by federal regulation to belong to a Federal Home Loan Bank, but that regulation is set to expire on April 19, 1995. 12 C.F.R. § 563.49. Any other eligible institution (a commercial bank, credit union or insurance company) may join the System, but is not required to belong. As the GAO noted in its report, a federally chartered savings association has the power to convert to a state charter and leave the system beginning in 1995.

All savings associations must maintain their status as a Qualified Thrift Lender in order to maintain their access to advances from a Federal Home Loan Bank. 12 U.S.C. 1467a(m). A QTL must keep at least 65 percent of its portfolio assets in housing-related assets. The background studies prepared for the HUD report indicate that because of statutory definitions of assets for purposes of the QTL test, a typical financial institution could satisfy the QTL test with 45 percent to 50 percent of its assets invested in mortgages and mortgage securities.

While there must have been sound reasons for the enactment of each piece of the membership requirement mosaic at the time of each modification, it is clear that the current structure can be improved. The GAO has noted that the current system of two classes of owners, some voluntary and some mandatory, increases the risk to the System, and that the adoption of an all voluntary membership should reduce the risk to the System and increase its safety and soundness. We agree.

The issue for future reform is what should become the minimum standard for entrance into the Federal Home Loan Bank System? The Federal Housing Finance Board takes the most aggressive position that the minimum limit of 10 percent of assets should be eliminated. That would certainly increase the ability of the Federal Home Loan Banks to make profits, but it would seem to be a significant erosion in the mission of the Federal Home Loan Banks

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to support institutions committed to housing lending. The GAO, on the other hand, states that maintaining some minimum requirement for holding home mortgage loans as a condition for membership makes sense. HUD also supports such a requirement. We agree. If the penalties for not meeting the QTL restrictions are eliminated, and stock purchase requirements are equalized, then some minimum threshold needs to be retained; whether the appropriate number is 10% or higher is a matter of judgment.

As part of comprehensive reform, for the long term, we think stock purchase requirements among all shareholders should be equalized. The two principles for constructing sound membership rules enunciated in the GAO study make a great deal of sense. First, the rules should equalize the benefits and burdens of membership for all members irrespective of charter type. As the CBO also noted, commercial banks now hold as much aggregate home debt as do thrifts. Second, the rules should give more control of the System to the shareholders of the Federal Home Loan Banks.

D. Capital and Governance Structure.

The HUD study states that safety and soundness regulation should be separated from the Federal Housing Finance Board's current managerial responsibilities. All observers of the System agree on that point. We believe that the boards of directors of the Banks should be responsible for managing the Banks, and that the safety and soundness regulator should be responsible for examining and supervising the Banks in a manner consistent with other regulators. Much discussion has occurred, and will occur, over the topic of safety and soundness regulation in the System and who the regulator should be. The issue is not so much who the regulator should be as what the regulator should do. The Federal Housing Finance Board accomplished its safety and soundness regulation duties, in part, through the exercise of management authority over the Banks. We believe the System would benefit from concentration of management authority in the Banks' boards of directors. The boards could then come together to create a central management entity or not, as they choose. The regulator should have the powers and authorities of the other financial regulators and should, in addition, have the responsibility to measure the Banks fulfillment of their statutory mission. The mission should be clearly defined in law and

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unambiguous. Such a scheme would make unnecessary the program regulator envisioned by the HUD Study.

We will defer our specific comments on capital structure until the studies of capital being performed within the System, which are currently in process, have been completed. Generally, however, we persist in our previously stated belief that the System as a whole, given its credit history and current business operations, is significantly over-capitalized.

III. CONCLUSION.

Our primary business is straightforward -- and low risk. The Federal Home Loan Banks make loans to members, and these loans are mostly secured by the home mortgage loans that the members make to home buyers. The Banks secure their advances with collateral that is of high quality and greater in value than the amount of the advance. The careful maintenance of a balance between paying a reasonable dividend and providing useful products, on the one hand, and fulfilling our public purpose, on the other, is an ongoing challenge for the Banks and the Congress.

Systematic reform is necessary in order to increase our efforts to help portfolio lenders and, through them, to help low-income communities. We need to attract new members and to provide financial incentives to our existing members, which requires us to return the Federal Home Loan Banks to a higher level of profitability without the artificial boost from investing in mortgage-backed securities. The REFCORP assessment, the membership requirements, the capital structure, and the governance structure need to be reformed.

The REFCORP assessment appears to be the most difficult issue to address politically. There is a solution, if Congress is willing to take a long view. The REFCORP assessment lasts for another 37 years, when the last REFCORP bonds are retired, but the pay-as-you-go rules measure the budget impact for only 5 years.

As the GAO noted, Congress could change the fixed obligation to a variable percentage of income, and require the Federal Home Loan

Banks to continue paying the government past the maturity date of the REFCORP bonds to the extent the present value of such variable payments was less than the value under the current fixed $300 million assessment. This reform would require a budget waiver because, although it is budget neutral over the 37 or more years that payments would be made on the REFCORP bonds, it is not budget neutral over the 5 year time frame used for scoring proposed legislation. It seems, however, that if ever a budget waiver would be warranted, it should be when GAO recommends it as a measure to reduce the long term risk to the taxpayer in a manner that is, in the long run, budget neutral. REFCORP reform, along with changes to the System's membership and capital requirements and to its governance structure, will enhance the Banks' ability to successfully perform their housing finance mission.

FEDERAL HOME LOAN BANK
OF SEATTLE

1501 Fourth Avenue
Seattle, Washington 98101-1693
(206) 340-2300
FAX (206) 340-2485

Twelfth District.
Alaska, Guam, Hawaii, Idaho,
Montana, Oregon, Utah,
Washington, Wyoming

TESTIMONY OF JAMES R. FAULSTICH
PRESIDENT AND CEO
FEDERAL HOME LOAN BANK OF SEATTLE

SUBCOMMITTEE ON GENERAL OVERSIGHT, INVESTIGATIONS AND THE RESOLUTION OF FAILED FINANCIAL INSTITUTIONS

MAY 24, 1994

Mr. Chairman and members of the Committee, thank you for this opportunity to share my thoughts and those of the Board of Directors of the Federal Home Loan Bank of Seattle on the recently issued report on the Federal Home Loan Bank System by the Department of Housing and Urban Development.

First, let me acknowledge the efforts of Secretary Retsinas in producing HUD's report to Congress on the Bank System. He has been tireless in his efforts to be inclusive in preparing the report, reaching out not just within the Administration, but to the Federal Home Loan Banks, our customers and the communities they serve. He has made a point of visiting a number of the banks, including ours in Seattle, to learn more about our operations and listen to our suggestions for improving the System.

We greatly appreciate Secretary Retsinas' efforts to reach out to us as the Administration considers reform of the Bank System. We are anxious to work as a partner in addressing the issues raised in the HUD report and the other studies mandated by Congress. While complete consensus on System issues will be difficult to achieve, I am optimistic that we can hammer out a course for the System that takes advantages of the strengths of the twelve banks while more aggressively meeting the housing and community development finance needs of our respective districts.

Mr. Chairman, perhaps the most important outcome of the five reports is the unanimous conclusion that the Federal Home Loan Banks continue to serve a significant public policy purpose. While the housing finance system is far different from when the Federal Home Loan Bank System was created in 1932, lending institutions that hold residential mortgages in portfolio continue to play a crucial role in providing financing for safe, decent, affordable housing. By enhancing the ability of lending institutions to meet the diverse housing needs we have in this nation, the Federal Home Loan Banks continue to serve an important and necessary purpose.

One-size-fits-all home financing simply does not work in all cases. In our district alone, we are working with our members to meet the housing needs of native Americans living on Indian lands in Montana, native Alaskans living miles from transportation facilities and native Hawaiians struggling against a depressed economy where housing prices are still extraordinary. We are working in partnership to address the housing needs of working poor and elderly in urban Seattle as well as the housing needs of the farmworker population in the rural portions of our district.

The simple fact is we need a housing finance system as diverse as the housing needs in this nation. That is why the Federal Home Loan Bank System makes a unique contribution to the home finance system.

For the past three years, I have had the privilege of serving as Chair of the Bank President's Housing and Community Development Committee. While there may be differences about some of the issues we face, there is unanimous agreement that the Affordable Housing Program and Community Investment Program have been unqualified successes.

In four short years, more than 27 thousand units have been developed nationally through the AHP program. We have developed nearly 6 thousand in our district alone. Nationally, 70 percent of the units of the active and completed units are rental; the remaining 30 percent are owner occupied. 64 percent of the AHP-assisted units are for very low-income persons, those whose income is 50 percent or less of the median income. And those units can be found in our largest cities and most isolated rural areas.

The Bank System's Community Investment Program program provides loans to help finance home creation for families whose income does not exceed 115 percent of the area median income, as well as financing economic development activities targeted to low- and moderate-income families and neighborhoods. CIP lending for the history of the program exceeded $4.5 billion at the end of 1993.

Perhaps the most important role the Federal Home Loan Banks play is not in just helping to finance affordable housing and community development programs, but in serving as a catalyst to bring together nonprofits and lenders. At each of our banks, our community investment staffs facilitate the making of deals that would not otherwise happen. One of our goals is to establish a solid working relationship between lenders and nonprofits so that future projects will be undertaken even without our financial assistance. As the HUD report notes, "the value of facilitating deal-making may outweigh the subsidy value of AHP and CIP."

The outreach efforts that each of the banks have undertaken underscores the importance of empowering to the greatest extent possible the Boards of Directors of each of the 12 Banks.

Reform of the Bank System provides an opportunity to decentralize authority, allowing each of the Banks to concentrate more of its staff time and resources on meeting community needs and less on satisfying mandates from Washington. We understand and support the need for a strong safety and soundness regulator and the oversite of Congress to assure that the Federal Home Loan Banks are strong and satisfying their public purpose mission. However, I would urge Congress to free the System to the maximum extent possible to meet the diverse needs of our districts.

What works in one area of our country does not necessarily work in others. In our view, a regulatory structure that encourages local innovation and experimentation is in everyone's interest. As part of this delegation of authority, my Board would welcome the flexibility to offer new products and services that might help our customers better meet the diversity of housing and community development needs that are so apparent in our nation.

Mr. Chairman, let me close by urging you and your colleagues to remain mindful of the irreplaceable contribution our members -- community-based financial institutions - make in all of our communities in ways large and small.

The First National Bank of Eureka, Montana pulled together community leaders to form an economic development council when the town was threatened by the closure of as timber mill. The council was able to attract a wood pellet producer, adding 20 new family wage jobs.

When Hurricane Iniki hit Kauai in 1991, Hawaiian financial institutions reacted with care and concern. American Savings Bank, for one, established a fund to collect donations for the relief effort and granted three-month extensions, without penalty, on all consumer and mortgage loans.

And in Seattle, Metropolitan Savings stepped-in to sponsor the carousel at Westlake Park in downtown Seattle that has come to symbolize our holiday season celebration in Seattle.

I doubt very much that companies without roots in their communities would have responded in such a way. As you consider possible reforms of the Federal Home Loan Bank System, I encourage you to consider what those changes will mean to those community-based financial institutions that are such an integral part of cities and towns throughout our nation.

Thank you for this opportunity to offer our perspective on the role the Federal Home Loan Banks currently serve and the potential the Banks hold.

TESTIMONY OF

MICHAEL T. CROWLEY, Jr.

CHAIRMAN OF THE FEDERAL HOME LOAN BANK

STOCKHOLDER STUDY COMMITTEE

BEFORE THE

SUBCOMMITTEE ON GENERAL OVERSIGHT, INVESTIGATIONS,

AND THE RESOLUTION OF FAILED FINANCIAL INSTITUTIONS

OF THE

COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

U.S. HOUSE OF REPRESENTATIVES

May 24, 1994

INTRODUCTION

Mr. Chairman and members of the Subcommittee, on behalf of the Federal Home Loan Banks Stockholder Study Committee (Stockholder Committee), I would like to thank you for this opportunity to testify on our views on the FHLBank System. My name is Mike Crowley. I am the President and Chief Executive Officer of Mutual Savings Bank, Milwaukee, Wisconsin, and Chairman of the Federal Home Loan Banks Stockholder Committee.

The Stockholder Committee was statutorily established by the Housing and Community Development Act of 1992[1] (HCDAct). The members of the Stockholder Committee formally presented our report, "The Future Direction of the Federal Home Loan Bank System", in July 1993.

The original request from the Congress provided representatives of the Bank System's owners with a unique opportunity to meet for the first time to assess and debate the structure of the Bank System, and to reach a consensus on the future evolution of the System. We gave the request particularly serious consideration, first, because of the importance of the System mission, and, second, because of the significance of our financial investments in the Bank System.

The Stockholder Committee consisted of 24 members--two stockholder representatives from each of the 12 Federal Home Loan Bank (FHLBank) Districts. (A list of the members of the Stockholder Committee is attached as Appendix A.) They were selected by the Board of Directors of each FHLBank. All are executive officers of their institutions and most are currently Directors of their FHLBanks. As a formal matter, the main work of the Committee was completed when we submitted our report last year, but we believe that the formation of the Committee was instrumental in developing an across-district dialog that continues to this day and that has continued to shape System decision-making.

The Stockholder Committee's first meeting was on December 14, 1992 and we held seven additional meetings, the last on June 2, 1993. We also had extensive discussions with interested parties on the issues in the questions outlined in the HCDAct. (A list of the parties is attached as Appendix B.) We greatly appreciate their cooperation and willingness to share their views with us and we know that the Congress will also be seeking their views directly. We would emphasize, however, that the Study Committee does have a unique stake in the outcome of the policy debate on the role of the System since we represent the providers of the System's capital and the bearers of the System's risk.

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[1]Public Law No. 102-550, 106 Stat. 3672 (1992).

The Stockholder Committee also collected, reviewed, and assessed information prepared by others regarding the Bank System, including studies prepared in 1990 and 1991 by the Department of the Treasury (Treasury), the Congressional Budget Office (CBO), and the General Accounting Office (GAO). We reviewed information prepared by the Federal Housing Finance Board (FHFB) in conjunction with its strategic plan for the Bank System (System 2000) and met on numerous occasions with FHFB members and staff. We held a briefing with Directors of the Bank System in Washington, D.C., on March 9, 1993, to discuss the progress of the Stockholder Committee at that time. Further, I testified at the FHFB hearings on the future of the Bank System held in Washington, D.C., on March 26, 1993. On May 26, 1993, we also met with the Presidents of the FHLBanks to exchange views about the Bank System's challenges and opportunities.

Congress has now received the full complement of reports about the Bank System, including the report from the Department of Housing and Urban Development which is also the subject of this hearing and which was submitted to Congress on April 19, 1994. Although others will contribute to the assessment of the Bank System, no other group has our perspective, interest, and commitment. The stockholders of the FHLBanks are the owners, members and users of the System: their FHLBank membership is an integral part of their institutions' operations.

The Bank System was created by Congress in 1932. Since that date it has served as an important part of this nation's housing finance mission. In 1989, the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA) made fundamental changes in the Bank System. The studies of the Bank System mandated by the HCDAct are particularly relevant because significant changes in the Bank System's operating environment since FIRREA has made many of the key assumptions underlying the passage of FIRREA ripe for review.

For example, the imposition of the FHLBanks' obligation to provide $300 million annually to the Resolution Funding Corporation (REFCorp) and the taking of $2.5 billion dollars of retained earnings from the FHLBanks on the initial formation of REFCorp were considered justified on the assumption that these were financial contributions of FHLBank members that had precipitated the thrift financial crisis. In fact, thrifts which are still members of the Bank system in 1993 were not the precipitators of financial crisis: to the contrary, they are most responsible for the thrift industry's restored financial stability.

Projections during the drafting of FIRREA regarding future earnings of the FHLBanks also proved to be overstated. In 1989 the $300 million REFCorp obligation approximated 20% of the FHLBank's 1988 earnings. Congress, in creating this obligation, expected that earnings of the Bank System would continue at 1988 levels, or even grow. However, that has not been the case for various reasons. In fact, in 1993 the FHLBanks earned only $972 million before the payment of the REFCorp obligation compared to $1.5 billion in 1988. The capacity of the System to meet the FIRREA obligations has begun to recover as advances, which shrank to half of their 1988 level of $150 billion, have recovered substantially, and, passing the $100 billion mark, seem destined to grow for the foreseeable future.

The System is not "broke" but it does need some fix-up. But repairs do not have to be done on an emergency basis. This important power source helping to drive the portfolio lending process is actually working far better than it was two years ago. These encouraging trends afford us an opportunity to consider the strategic issues facing the System.

HOUSING FINANCE MISSION

The most basic topic to be decided for the System is updating and clarifying the mission statement. Definition of the public purpose for the System will highlight the areas where reform is most needed.

As stockholders and members of the FHLBanks, we believe the Bank System has made a significant contribution to housing finance throughout its history. More recently, the FHLBanks have been given additional responsibility for affordable housing, the major sector where housing credit flows remain constrained. We support the Bank System and depend on it in our day-to-day business. In our view, the mission of the Bank System is:

1. To promote the availability of housing finance to households of all income levels throughout the country in widely varying financial and economic cycles through the provision of advances and other services to member institutions.

2. To operate in an efficient, safe, and sound manner through the prudent management of risk to provide the Federal Home Loan Banks' members with access to competitively priced funds; liquidity; and high value financial, correspondent, and management services so that members, particularly those holding home mortgage portfolios, can more effectively compete and respond to the requirements of their markets.

3. To preserve stockholders' capital while simultaneously fulfilling the Federal Home Loan Banks' public trust and providing an acceptable rate of return to stockholders.

4. To provide members with the funds and programs necessary to expand affordable housing, thereby significantly enhancing the development of communities throughout the United States.

As with any brief mission statement, a set of assumptions and implications is embedded in the text. The first and last points of the language that the Stockholder Committee offers for your consideration emphasizes the housing role of the System. The System's center of gravity must rest on the expertise of its professional staff and member institutions in this area.

The System functions on the "wholesale" level of financial services intermediation. It truly is a "bankers' bank". In most cases, the individual mortgage or business development borrower is completely unaware of the assistance that the System has provided. The access to the virtually unlimited liquidity of the System enables an institution to make far more loans within any given balance sheet total. This source of liquidity is actually more flexible than secondary market securitization since the loans do not have to meet this market's standardization criteria. Accordingly, the System offers this support to the overall portfolio lending efforts of its members but does place particular emphasis on the affordable housing segment for low-to-moderate income borrowers. The most effective assistance that the System can offer in neighborhood revitalization is housing credit, but we appreciate that the Community Investment Program (CIP) can be put to broader use and we can see real potential for that line of business when a local lender or government body sees a good fit.

As these public policy goals are pursued consistent with that mission, the Committee also feels that preservation of the financial integrity of the System is vital. The Committee spent a great deal of time discussing ways to enhance the System's contribution to community development without raising safety-and-soundness concerns. As community-based lenders, we want to be involved in the measures that the Congress is directing to enhance access to credit and economic development for neighborhoods that have taken a back seat on the national agenda for too long.

COMMUNITY DEVELOPMENT

The Bank System and its members intend to continue to be major participants in community development banking and in any discussion relating to expansion of community development banking. We have developed the following recommendations for System activities to assist in that overall effort.

The Affordable Housing Program (AHP) could be more effectively administered if approval for program subsidies for individual projects is transferred from the FHFB to the local FHLBanks. We appreciate the thrust of the proposed regulation to that effect still pending at the FHFB but many member institutions are concerned that the proposed regulation remains far too complex. This feeling is shared by many not-for-profit partners in the AHP. We are gratified that the HUD report confirms our views on this point.

The Committee also suggests that, in the event of a merger of individual FHLBanks, branches or other types of local offices should be maintained to ensure that the effectiveness of the affordable housing and community development programs is not reduced. Again, the HUD report is consistent with our own views on this topic.

Our group also studied the relative affordable housing contribution of each of the housing sector GSEs. We note that the System is the only one of the three with an objective, dollar subsidy requirement, soon to reach $100 million per year. Though Fannie Mae and Freddie

Mac have specific targets for low-to-moderate and central-city lending, they expect to show a profit margin on these loans that is not significantly different from the rest of their book of business.

The financial commitment of the FHLBanks and their members to affordable housing substantially exceeds that burden. Thus, the goals established for these other GSEs are not relevant to the FHLBanks.

Our position on these issues was developed while the Congress was in the very early stages of drafting the important Community Development Financial Institutions bill, H.R. 3474. We support the thrust of this legislation. Personally, I would like to thank the Congress for the inclusion of a measure of regulatory relief within that pending legislation.

I believe that I can speak for all of the Stockholder Committee members when I emphasize that we are committed to performance over paperwork and to the enhancement of real community credit access. Portfolio lenders have voiced concerns that well-intentioned regulatory revisions under the Community Reinvestment Act will be very counterproductive. We hope that we can achieve real simplification and real upgrades in performance. We also support the targeted incentives that have been included in the Bank Enterprise Act title of this legislation and we applaud the willingness of the sponsors of this provision to consider innovative approaches.

I do believe that, consistent with the basic mind-set of the stockholder report, the application of formal percentages of low-to-moderate mortgage loans (or other designated assets) against FHLBank advances outstanding can never be a workable approach to ensuring appropriate use of these funds. Many institutions are occasional borrowers from the System but their commitment of funds to these uses is ongoing, stable, or increasing. The community support/CRA review regime is better suited to assurance of mission fulfillment because of the difficulty of such asset/liability linkage caused by the fungibility of liability issuance proceeds.

PRODUCTS AND SERVICES

A more effective way to enhance the community development activities of the System is by seeking new business uses for its funding and credit enhancement capacity.

The expansion of the product menu for the System in support of community development or for other reasons must be carefully handled. Four basic criteria must be met before any new housing-related credit product or service should be offered by the FHLBanks to their members. New housing-related credit products and services must:

- ▲ Promote the Bank System's mission of housing finance;
- ▲ Be primarily an extension of credit for housing and housing-related finance for which the Bank System has the greatest amount of experience and expertise;
- ▲ Neither change the risk profile nor result in significant additional risk to the FHLBanks;
- ▲ Not duplicate housing-related credit products and services already offered by members.

After consideration of these four criteria, the Committee concluded that the Bank System should not purchase unsecuritized housing-related assets or make direct loans for housing or housing construction. These recommendations were the same as those on this topic within the HUD report.

The Committee did feel that the current limitation (30% of each member's capital) on the amount of residential real estate-related assets other than fully disbursed first mortgages or MBS that can be accepted by the FHLBanks as collateral for advances should be removed. It should be replaced by uniform limitations and guidelines to be monitored by the individual FHLBanks.

To maintain proper risk control procedures for reasons of safety-and-soundness, the stockholders, through their local Boards of Directors, should have final approval of any new product or service, and access to existing or new products and services should be available only to those currently eligible for access to FHLBank products and services. As a means of expanding their community development efforts, the FHLBanks should continue to offer credit enhancement services related to housing finance.

Furthermore, the FHLBanks should also be able to act as facilitators or clearinghouses for the syndication of loans that may be too large for individual members, but only at the request of members.

To address the financial exposure from these new activities, the Committee suggests that pilot programs to test new concepts and minimize risk may be an appropriate way to enhance feasibility of product alternatives. The FHLBanks should have the ability to establish limited purpose subsidiaries for this purpose. The operation of any pilot program(s) should be limited to the geographic district of the sponsoring FHLBank(s).

Capital: Adequacy and Reform

The above suggestion of using special purpose subsidiaries or pledged capital to manage the risk of new activities indicates the substantial attention that the Stockholder Committee paid to safety-and-soundness. The appropriate balancing of the countervailing forces to expand activities and to enhance capital was a major factor in the rewriting of the rules for Fannie Mae and Freddie Mac. Similar attention is necessary for the Bank System.

We would note, however, that capital investment in the Bank System is higher than needed for safety and soundness purposes under any traditional assessment of risk, including the ability to survive a risk-based capital stress test similar to the one required for Fannie Mae and Freddie Mac. The stockholders' contributions to capital should be reduced, subject to the ability of the Bank System to pay its REFCorp assessment and AHP obligation.

The minimum safety and soundness capital standards for the FHLBanks and the Bank System should be based on risk and overall financial condition, similar in purpose to the "stress tests" developed for these other two GSEs.

Ongoing capital adequacy standards for the Bank System should also reflect the ability to:

- Maintain the AAA credit rating;
- Cover the REFCorp assessment and Affordable Housing obligation; and
- Provide of a reasonable dividend to stockholders.

The Bank System should have the necessary tools available to address capital adequacy, including the authority to permit the FHLBanks to issue different classes of stock to members, build permanent capital, and retain earnings without fear of confiscation.

The Stockholder Study Committee is pleased that these recommendations on capital, which were developed and delivered in our final report last July, began the consideration of the topic of provision of "permanent" capital for the System. This theme was expanded in the CBO and GAO reports that were completed after our work. The HUD report addresses the issue in somewhat greater detail but does not give any specifics on the capital instruments that might be employed.

A great deal of discussion took place within our Committee last year and I would emphasize that the involvement of the equity holders in any reconfiguration of the capital base is vital. At this point, virtually all of the capital in the System is represented by the holdings of redeemable common by the member institutions. Their reaction to any proposed overhaul will be critical to its feasibility and success.

Governance

Since members are the providers of the System's entirely private capital, they deserve a serious review of their role in governance. The studies that have addressed the issue in depth, those presented by the GAO and HUD, have recommended a separation between regulation and management. This issue was, however, first seriously raised by the Stockholder Study Committee.

This enhanced stockholder control should be accompanied by even greater federal attention to safety and soundness via a single purpose regulator patterned after the office of Federal Housing Enterprise Oversight, the overseer of Fannie Mae and Freddie Mac. The HUD report actually recommends a merger of the FHFB and OFHEO.

Our report was not so specific, but the committee discussed a range of alternatives for the location of this regulatory authority, including the Treasury, since fiscal soundness was the suggested focus for this operation.

The committee also recommended the creation of a central policy entity with a small staff and a Board of Directors to be responsible for Systemwide principles and policies, such as joint and several liability issues, capital, and risk management. Individual FHLBanks' Boards of Directors should elect one member to the Bank Systems' central policy entity. With that coordinating body in place, to the maximum extent feasible, local policy-making and governance decisions should be vested with the local FHLBanks' Boards of Directors. Management of the local FHLBanks should be in turn vested with local management responsible to their respective Boards of Directors.

The Stockholder Committee encourages consideration of consolidation among the FHLBanks. Concern for both shareholder control and a local presence requires that any consolidation among individual FHLBanks should be recommended by their respective Boards of Directors and approved by their stockholders. Legal impediments to consolidation should be reviewed and modified, or removed, as appropriate.

As part of that process, the Bank System's central policy entity should conduct a thorough study of the issues relating to consolidation of the FHLBanks, including but not limited to cost savings and the function, structure, and efficiency of the FHLBanks. These recommendations are again broadly consistent with the HUD study.

Since our committee was intimately familiar with the management of the individual FHLBanks, we did make two further recommendations on governance. First, the Chairmen and Vice Chairmen should be elected by the local Boards of Directors. The Presidents of the local FHLBanks should be selected and appointed by the local Boards of Directors.

Second, the terms of elected directors of the local Boards of Directors should be established at four rather than two years to be consistent with terms of the appointed directors. Directors should not be permitted to serve more than two consecutive terms.

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Membership Recommendations

Voluntary membership on a uniform basis must be extended to all members of the FHLBanks. A two-class membership, with different obligations and rights, is divisive, inefficient, and unsustainable. Access to membership in the FHLBanks should continue to be available only to thrifts, commercial banks, credit unions, and insurance companies, as under current rules since these are the nation's portfolio lenders.

Because of that orientation towards portfolio lenders, the current statutory minimum requirements for eligibility, including the requirement that insured depository institutions have at least 10 percent of their total assets in residential mortgage loans, should continue to apply.

Consistent with uniform rules for membership, the stock purchase requirement for all members should be equalized when a single class of voluntary members is created. A two-pronged approach under that new uniform standard for members still continues to make sense, with some modest adjustment.

The stock purchase requirements should be determined by the Bank System's central policy entity, based on financial need and computed as follows:

- The initial stock purchase requirement should be based on a percentage of total assets rather than mortgage assets; and

- The stock purchase requirement for members to obtain advances should be based on a uniform percentage of advances.

FHLBank members that are currently required to meet the QTL test should be eligible to obtain advances without the QTL test qualification and limitations on the amount of advances the Bank System may extend to non-QTL members should be eliminated.

Since members should be free to leave if they so desire, some constraint is necessary to prevent "revolving door" memberships. Thus a member who voluntarily withdraws from the Bank System should not be permitted to rejoin for five years.

These recommendations are consistent with those contained in the other studies but we emphasize that it is important to proceed with these changes in concert.

To quote directly from the text of our report: these issues "are significantly interrelated and cannot and should not be addressed in isolation. The Stockholder Committee is presenting interdependent recommendations that should be considered in their entirety. If they are not considered in their entirety, our positions on specific issues may be different."

The Committee's recommendations were unanimous, in part because of the careful balancing of the individual items within the overall package. We are aware that the Congress is unlikely to adopt every provision in our report, or in any of the others, without adjustment. Even so, we urge careful consideration of the connections between individual components of any package of System reform amendments.

Naturally, the Congress is experienced in weighing competing arguments as legislation is crafted. That is the very nature of the legislative process. In that regard, we commend to your attention one final and difficult issue that hangs over from FIRREA.

That is the inflexible, first-dollar call on System earnings for the REFCorp contribution. We suggested a move to the flat 20% "tax rate" originally contemplated in FIRREA as a continuation of the old 20% transfer to the so-called legal reserve. We were, however, seriously concerned by the potential shortfall that such a switch might create.

We are intrigued by the approach outlined in the GAO report whereby any shortfall or surpluses from the 20% "tax yield" could be debited or credited to an interest bearing account to equate to the same "present value" burden but maintain the flexibility of the System. We did not offer that solution in our report but I have discussed it with the members of our committee and we all agreed that it would be an equitable way to restore flexibility to the System's operation.

If nothing else, the range of analysis that has been presented to the Congress from the individual perspectives of these five studies shows the wisdom of commissioning them in the first place and digesting their contents before moving legislation.

I would be happy to take any questions on the study that we submitted or on those presented by the other entities. Thank you for this opportunity to express our views.

APPENDIX A

FEDERAL HOME LOAN BANK SYSTEM STOCKHOLDER COMMITTEE

FEDERAL HOME LOAN BANK SYSTEM
STOCKHOLDER COMMITTEE

Chairman
Chicago

Michael T. Crowley, Jr.
President & CEO
Mutual Savings Bank

Vice Chairman
San Francisco

James F. Montgomery
Chairman
Great Western Bank

Atlanta

Richard E. Funke
Chairman & President
Atlantic Federal Savings Bank

Lynn W. Hodge
President & CEO
United Savings Bank, FSB

Boston

David F. Holland
President & CEO
Boston Federal Savings Bank

Herbert W. Cummings
Vice Chairman
Citizens Savings Bank

Cincinnati

Larry A. Caldwell
President
Cambridge Savings Bank

Tony D. Whitaker
President
First Federal Savings Bank

Chicago

John A. Becker
Chairman & President
Charter Bank, FSB

Dallas

Skip Martin
President
Pocahontas FS&LA

Manuel J. Mehos
Chairman & CEO
Coastal Banc Savings Assoc.

Des Moines

Donald A. Glas
President
First State FS&LA

Michael J. Gorman
President
United Postal Savings Assoc.

Indianapolis

*Garry G. Carley
Executive Vice President
Standard Federal Bank

C. Gene Harling
Chairman & CEO
First Federal of Michigan

New York

Kenneth H. Van Saders
President
Clifton Savings Bank, SLA

*George L. Engelke, Jr.
President
Astoria FS&LA

Pittsburgh

Iorman L. Keller
resident & CEO
nnview Savings Bank

vard J. Molnar
ident & CEO
eysville Savings Bank

Topeka

*Richard T. Pottorff
President & CEO
Mid-Continent FS&LA

*Frank C. Sidles
President & CEO
Provident Federal Savings Bank

San Francisco

Herbert M. Sandler
Chairman & CEO
World Savings and Loan Association

Seattle

*H. Brent Beesley
Chairman & CEO
Heritage Savings Bank

G.J. Pittenger
President, Washington Division
Great Western Bank

(*) Subcommittee Chairman

APPENDIX B

CONTACTS WITH INTERESTED ORGANIZATIONS

CONTACTS WITH INTERESTED ORGANIZATIONS

The Stockholder Committee has held extensive meetings with individuals representing both public and private sector organizations. We have considered all viewpoints and perspectives on the various issues confronting the Bank System. We have also met with other interested organizations on a continuing basis.

Wherever possible we have followed up preliminary contacts, met with them, and exchanged documents to understand, to the fullest extent, the impact of our recommendations on other organizations and interests involved in the Bank System.

The following individuals, agencies, and institutions have met with FHLBank stockholder representatives:

Agency/Institution	Contacts
American Bankers Association	Kenneth Clayton, Senior Federal Legislative Counsel and Gail Bolcar, Senior Policy Analyst
Congressional Budget Office	Douglas Hamilton, Principal Analyst, Fiscal Analysis Division
Congressman Richard Baker's Office	Duane Duncan, Legislative Director & Counsel and Paul Sawyer, Legislative Assistant
Department of Housing and Urban Development	Ben Laden, Director, Financial Institutions Regulation Staff; John Ross, Director, Economic and Public Finance Division; and John Gardner, Senior Economist
Department of the Treasury	Mark Kinsey and Margaret Nilson, Financial Economists
Federal Home Loan Bank Housing Advisory Councils	Chairpersons
Federal Home Loan Bank System	Presidents and Directors of the FHLBanks
Federal Home Loan Mortgage Corporation	Mitch Delk, Vice President, Government and Industry Relations; Ed Golding, Director, Policy and Planning, Financial Research Department; and Dick Pratt, Consultant
Federal Housing Finance Board	Board Members and Staff
Federal National Mortgage Association	Annette Fribourg, Vice President, Regulatory Activities, and Mark Obrinsky, Senior Economist
General Accounting Office	Bill Kruvant, Assistant Director, Financial Institutions and Markets; Ed DeMarco, Senior Economist; and Patrick Doerning, Operations Research Analyst
Independent Bankers Association of America	Diane Casey, Executive Director; Karen Thomas, Regulatory Counsel; and Ann Grochala, Director of Bank Operations

Mortgage Bankers Association	Phyllis Slesinger, Senior Director, and Victoria Vidal, Associate Director, Residential Finance/Government Agency Relations.
National Association of Home Builders	Kent Colton, Executive Director; David Ledford, Staff Vice President; David Seiders, Chief Economist; and Kathy Gerlach, Legislative Director
Neighborhood Reinvestment Corporation	George Knight, Executive Director
Office of Thrift Supervision	Jonathon Fiechter, Acting Director, and John Price, Acting Assistant Director for Policy
Savings and Community Bankers of America	Martin Regalia, Director, Economics and Research, and Alfred Pollard, Director, Government Relations
Senate Banking Committee	Pat Lawler, Chief Economist

Testimony of

David F. Holland

Chairman

Savings & Community Bankers of America

before the

Subcommittee on General Oversight, Investigations,

and the Resolution of Failed Financial Institutions

of the

Committee on Banking, Finance and Urban Affairs

U.S. House of Representatives

May 24, 1994

Introduction

Mr. Chairman, it is a privilege to appear today to present the views of the Savings and Community Bankers of America, the national trade association representing community-based, housing-oriented depository institutions. I am David F. Holland, chairman and CEO of Boston Federal Savings Bank and chairman of SCBA. I have also previously served as the chair of SCBA's special committee on the FHLBank System. I would like to emphasize that I am appearing strictly in my capacity with SCBA, even though I do currently hold the position of Vice-Chairman of the Federal Home Loan Bank of Boston.

SCBA appreciates your timely call of an oversight hearing on the future of the System. Substantial changes have occurred in the five years since the System was radically revised by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA). The Congress was wise to request a review of the progress of the System from a wide variety of perspectives in the five studies mandated by the Housing and Community Development Act of 1992. The last of these studies was published by the Administration via the Department of Housing and Urban Development last month and formal Congressional deliberation on the analysis and recommendations of those studies begins here today.

Community Development Mission

That review will enable appropriate changes in the role of the System in sound community development efforts. SCBA is well aware that this is a top priority item for the members of this subcommittee, the full committee, and indeed the entire Congress. It is also an item of utmost concern to SCBA member institutions which can ultimately enjoy no better fortune than the communities which they serve.

The important Community Development Financial Institutions bill, H.R. 3474, encourages the creation of financial institutions to enhance access to financial services in lower income communities. Since this was the genesis of many SCBA member institutions with original charters dating back to the last century, this is an approach that we can heartily endorse, provided that the focus of any specially-treated entity such as a community development credit union remains tightly targeted to the special purpose for its creation. If that special linkage is loosened, the special treatment, e.g. tax exemption, should be eliminated. Of course, the efforts of these newly created institutions will complement the ongoing and enhanced efforts of institutions already in operation.

We would emphasize that the provisions of the Community Reinvestment Act are being enforced with renewed vigor, and that, quite apart from this greater supervisory attention and the ongoing joint agency effort to streamline the CRA regulation, many institutions have devoted substantially greater resources to these market areas for both economic and social reasons. SCBA has voiced serious concerns about the details of the proposed interagency revisions to the CRA regulations. Though the intent is laudable, we believe that the complexity of the proposal will distract institutions from the real business of providing credit. Assisting these lenders is the basic purpose of the System.

The major focus of the Federal Home Loan Bank System within this overall effort should reflect the System's title: Home Loans. We share the view, however, that mortgage credit access is at best a necessary but not sufficient condition for neighborhood revitalization. The existing statute contemplates the use of specially priced Community Investment Program (CIP) advances for both mortgage and broader scope credit extensions in low-to-moderate income neighborhoods.

This is consistent with the limited risk capacity of the System and its "wholesale" orientation. The System provides the funds and a share of the "human capital" for the project but the member provides another slice of the human capital, the sweat equity, and all of the financial capital that takes the credit risk (and often at least part of the interest rate risk) of their deployment. Advances, under the CIP (or even Affordable Housing Program funds), are not grant funds to be deployed as costless "seed money" by the FHLBank. Ultimately, the credit risk on advances deployment lies with the member institution and, secondarily, with System stockholders. It is the member institution that delivers the credit to the community using the system as the funding source. This wholesale/retail partnership is what gives the System its outreach capacity and its financial integrity.

To preserve that integrity, since risk capacity was so substantially reduced by the loss of the retained earnings cushion, substantial overcollateralization of advances is demanded. This overcollateralization has protected the System throughout a period of highly adverse mortality experience within its membership.

Collateral Eligibility Standards

The restriction of collateral to mortgage product was explicitly reimposed in FIRREA to maintain the focus of the System on housing finance. In addition, FIRREA provided that "(a)ll long-term advances shall only be made for the purpose of providing funds for residential housing finance", which created something of a conflict with the broader scope CIP initiative.

As a practical matter, the restriction of collateral to real estate mortgage product has not normally created a problem since the mix of regular lending normally provides an excess of eligible collateral. The major problem in advancing credit for community lending by any insured depository, as community development financial institutions are designed to be, is the sometimes overly harsh scrutiny of safety-and-soundness examiners who often criticize the very loans praised by CRA compliance examiners.

In large measure, this phenomenon has been understood by the homebuilding community which has shifted its focus from requests for a greater role for construction loans as eligible collateral to efforts to reduce the likelihood of a presumption of suspect status for such credits in the examination process.

A focus on the largely irrelevant topic of eligibility as collateral for CIP commercial (non-real estate) loans will deflect attention from the more significant issues of integration with Small Business Administration programs and the loan securitization provisions elsewhere in H.R. 3474. Furthermore, unless the provision is intended to proceed to "micromanagement" levels of intervention in FHLBank operations, the eligibility of riskier credits will be addressed by higher overcollateralization requirements, especially if an offset against FHLBank stock holdings is not available because of the elimination of the regular advances-based stock purchase requirement.

The targeting of limited financial and human capital resources is essential if the most productive coordination of the full range of federal departmental, agency, not-for-profit, and private sector efforts is to be achieved. This is the reason why SCBA joined with ACORN and other community groups in opposition to the quantum leap in Federal Housing Administration (FHA) loan limits proposed in the housing bill, H.R. 3838. Tight focus on the segment of the market in most need of federal assistance in accessing both mortgage and business credit is essential.

Support for Portfolio Lending

I want to emphasize how proud we are of the achievements of the Bank System over six decades and the priority we place on its primary role as a central liquidity source for regulated depository institutions whose business vision and strategies incorporate a major role for housing finance.

My institution happens to be a mandatory member of the Home Loan Bank System, but membership in the Boston FHLBank gives a special perspective on the status and evolution of the System since the majority of the stock has, for many years, been held by traditional savings banks that, as voluntary members, have the option of withdrawing from the System.

Since FIRREA, not one voluntary member of the Boston bank has withdrawn. In fact, the Bank has added about one hundred commercial banks and credit unions as voluntary members. The most important reason for that is the value of the most basic functions of the FHLB System -- liquidity and access to funds to finance home ownership.

The benefits to housing finance of the liquidity function go far beyond a mere management tool. Billions of dollars in mortgage and other lending are made available because of the lower liquid asset holdings made possible by the availability of FHLBank funding. The balance sheet does not get "loaned up" until a significantly higher percentage of loans, especially long term mortgage loans, has been accommodated.

SCBA believes that the role of the FHLBank System in enabling its stockholder members to meet the financing needs of their communities as portfolio lenders remains viable and important. We are encouraged that the Administration, via the HUD report, shares that view. Though adjustments are needed, the System has served a valuable role and continues to offer necessary support to the portfolio lending function. The System has also shown impressive ability to adapt to the new policy mandates in the five years since FIRREA. As new activities are being considered for the System, it is vital that the ability of the current structure to promote public policy goals be recognized and preserved.

As interest rates firm up as the recovery proceeds, the market appeal of adjustable as compared to fixed rate mortgage product will be enhanced and portfolio funding demand will increase. The continued vitality of traditional functions is the base from which the System can expand prudently into new activities with both its traditional and new membership base. As members' capital increases, the ability to support the type of portfolio loan that can be funded by FHLB advances will grow.

Even so, the goal of capital preservation ranks higher on the immediate agenda of many FHLBank stockholders than stretching to boost the dividend rate. Stockholders do not want to jeopardize the primary public purpose of the System by pursuit of additional goals beyond the System's capital capacity in attempts to boost dividends from the earnings from inappropriate activities.

It is always very important to bear in mind that virtually all of these issues are interrelated. For example, the REFCorp burden has a bearing on the topics of voluntary membership and capital adequacy. Also, the expansion of products and services is hard to accomplish without achieving voluntary membership for all.

Current System Status

Since these issues are so intertwined, each of these studies emphasizes the need for a coordinated, comprehensive approach to the reform of the System. The System is not in crisis. It is certainly true, however, that many of the assumptions implicit in the feasibility analysis for the financial burdens placed on the System by FIRREA proved substantially inaccurate. The loss of over $2 billion in retained earnings to defease the principal of bonds issued by REFCorp, the proceeds of which were turned over to the Resolution Trust Corporation for problem case disposition, increased the leverage of the System, reduced the permanent capital cushion and risk capacity of the System, and compromised its earnings capacity.

Earnings are an important element of the FIRREA structure since the ongoing burdens placed on the System were predicated on continuation or growth of the $1.5 billion in earnings recorded in 1988, the last year prior to FIRREA's enactment. The $300 million annual assessment for debt service on the REFCorp bonds plus the $100 million annual contribution to the Affordable Housing Program have imposed a far greater burden on the System than originally projected or intended.

System earnings dropped to only 57% of that projected $1.5 billion level, almost doubling the percentage burden of these first-dollar, lump-sum charges against earnings. These fixed charges virtually eliminated the System's flexibility to expand and contract with business cycles. The most logical way for the System to finance these obligations was to engage in arbitrage of securities investments funded by issuance of agency consolidated obligations as a means of maintaining balance sheet size and earnings volume. Fortunately, the need to resort to this investment expedient is diminishing as advances demand has picked up to approximately $100 billion from the 1991 low of $79 billion (off from the 1988 peak of $153 billion).

Though the last five years have put considerable stress on the System as it navigated through rougher waters than charted, the System has been able to cope with these problems. Now the System must be provided the tools and the flexibility to fulfill its mission of facilitating lending for homeownership and related community purposes.

Advances to Non-QTL Members

As the outlook for the System has improved since the time immediately after FIRREA, advances demand has become so buoyant that some are foreseeing a problem from a different direction. This is the argument that the System is in urgent need of relief from the limitation on advances to members that do not satisfy the complex Qualified Thrift Lender (QTL) test. This limit is 30% of aggregate advances under current law. A provision lifting that limit from 30% to 40% has been included in the House version of the community development financial institutions bill.

Though this may appear on the surface to be a modest, noncontroversial amendment, a closer analysis of the need for this increase and the ramifications of such a change quickly illustrate the advisability of a comprehensive approach.

SCBA is uniquely situated to take a "systemic" view. It is the only national association representing the interests of both mandatory and voluntary members of the System, and both BIF and SAIF insured. Furthermore, the depository sector segment comprising SCBA membership holds 73% of the $11.25 billion in FHLBAnk stock outstanding, a substantial majority of the System's equity capital.

Commercial banks (and to a much lesser extent credit unions and insurance companies) own the balance of the common stock, 27%. Furthermore, commercial banks are now the largest membership segment by number, approximately 2,500 and still growing.

These are the sorts of statistics used to adduce the need for immediate relief from the 30% limit: over 50% by number of member institutions and already almost 30% of stock ownership. Don't some FHLBanks thus need quick relief since, after all, these are System-wide averages?

The accurate answer is "no"! First, the ceiling does not target commercial banks, just non-QTL members. A great many of the commercial banks that have joined the System actually meet the full QTL requirement and thus do not have their advances counted toward the ceiling. And, of course, the more a commercial bank borrows from the System to fund mortgages,the easier it will be for that institution to attain and maintain QTL status. Second, the ceiling does not apply on a FHLBank-by-Bank basis but to the System as a whole. Overall, according to a recent Federal Housing Finance Board memorandum to the Treasury Department, non-QTL advances, as of year-end 1993, stood at 8%, or about $8 billion of the $102 billion outstanding. The FHFB noted that, although five of the largest QTL commercial bank users are in QTL compliance by a modest margin, their loss of that status, which is only measured annually for commercial bank members, would cause the figure to rise to only 11%.

Any serious analysis of this issue should address the economic incentives for a commercial bank that is on the margin of satisfying the 65% threshold QTL requirement to remain above that level. This very topic illustrates the need to look at the full range of provisions of the statutory framework.

Section 10(a)(1)(B) of the FHLBank Act requires that the capital stock purchase requirements of a non-QTL member are "grossed up" by a factor equal to 100% divided by the actual QTL fraction for the institution. For a QTL member, the stock purchase requirement is only 5% of advances. Thus, if the QTL percentage is 65.001%, only $50,000 in the FHLBank stock is needed to support $1 million in advances.

But if the QTL fraction is 64.999%, the institution fails the QTL standard (which is pass/fail, with no gradations) and that $50,000 purchase of stock is grossed up by a factor of roughly 1.538 for a value of $76,924 in FHLBank stock to support $1 million in advances. (See Table 1.)

There is a tremendous incentive to stay at or above that 65% QTL limit for any commercial bank that is a significant borrower from the System. Modest attention to balance sheet management can achieve this result. Large, sophisticated commercial banks understand this perfectly well. Since five such commercial banks apparently account for about $3 billion in advances, and are currently modestly above the threshold, the risk of their backsliding below the 65% QTL threshold, with an addition to the non-QTL component of advances volume, is clearly remote.

It is significant that the bulk of advances outstanding to commercial banks, $8 billion of the $16 billion total, is to banks that already pass the QTL test. The average QTL percentage for all member commercial banks is about 50% but since the proceeds of advances to such members must be for the purpose of mortgage loans, the QTL percentage may rise somewhat over time.

Even though the percentage of advances subject to control is clearly not anywhere in the vicinity of the 30% limit right now, the possibility of an explosion in advances demand from that membership segment has been raised. It is true that commercial bank members have made a conscious decision to join the System and presumably are motivated to borrow: otherwise, why join in the first place?

By contrast, many savings institutions are mandatory members and may have no interest in accessing the advances window. On that line of argument, new commercial banks may be more likely to borrow than the traditional member and the "advances explosion" scenario made more plausible.

The segmentation of existing System membership offers a chance to test that contention. Traditional, BIF-insured savings banks, concentrated in the Northeast region of the country, have long been voluntary members of the System. They, too, are presumably members motivated by access to the liquidity and longer-term borrowing via advances. Despite that self-selection, however, this membership segment of the System has not been a disproportionately heavy borrower (see Table 2).

It is quite reasonable to assume that commercial banks will approach a similar percentage as they "move up the learning curve" and acquire complete familiarity with the System's advances programs. Such an adjustment would suggest a long-run equilibrium percentage of almost exactly twice the current value for the non-QTL member advances share of total advances as these commercial banks acquire the ingrained familiarity that has been achieved by the typical savings bank member.

Full reflection of that adjustment process under existing rules would generate a non-QTL member advances share of around 16%, twice its current value but still nowhere close to the 30% limit.

It may well be that this limitation will be removed as part of a comprehensive package. SCBA, in fact, fully supports such a change but only as part of such a comprehensive package. Enhanced access for one segment of the membership must be accompanied by elimination of unique constraints on others. The burdensome nature of QTL-related restrictions is by no means confined to the currently non-binding limit on advances to non-QTL member banks. If a thrift member fails the QTL test, no advances can be provided at all, even if there is room under the 30% limit. Nor can such a federal thrift institution that is no longer eligible to borrow even leave the System since the exits are blocked by statute.

Any comprehensive reform must address not just these complex QTL relationships but also the interconnected issues of governance, consolidation, capital membership eligibility, and expansion of the product line. The rest of this statement covers these areas and the final item of revising the structure of the REFCorp contribution.

Governance

As the Congress reviews the mission of the System within the overall framework of comprehensive reform, the basic governance structure must itself be reconsidered. We believe that the emphasis of the provision in the 1992 statutory revisions covering the other two major housing sector government sponsored enterprises (GSEs) on the safety and soundness component is a valuable template for a modernized regulatory structure for the System in its role as a "wholesale" bank.

We have appreciated the efforts, within the constraints of the current statute, of the Federal Housing Finance Board under the leadership of both the former Chairman Evans and now Assistant Secretary Retsinas to achieve an appropriate separation of regulation and management. Delegation of management authority to the boards of directors of the 12 individual FHLBanks should be vigorously pursued. We believe that this governance issue runs as a common thread across many of the topics raised by the 14 areas mandated for study in the reports now submitted to the Congress. Linkage of issues across bank district lines is also constantly involved because of the joint-and-several liability for consolidated obligations.

SCBA originally supported the position taken by the General Accounting Office in its 1991 study on GSE structure that the central location for System governance should be at arm's length from the federal regulator. Such a structure would allow the System to give freer rein to its innovative impulses while constrained by stockholder control and subjected to backstop federal regulation. The GAO reiterated this conclusion in its statutory report on the FHLBank System on the basis of further analysis and the HUD report took the same view. SCBA supports the emerging consensus on this issue. Shareholder involvement in management decisions, separate from the regulatory process, is essential.

Consolidation and Operating Efficiency

In fact, we believe that great care is necessary in the exercise of the existing statutory authority of the FHFB regarding consolidation. The current statute permits the consolidation of the existing 12 FHLBanks down to no fewer than eight. SCBA believes that all consolidation decisions should be guided by concern for the rights of the affected FHLBank stockholders. Regular business consolidations are predicated on the consent of the stockholder. Such decisions within the FHLBank System should be structured the same way.

We appreciate the efforts to date of the FHFB in pursuing "functional" consolidation across bank districts in computer systems, administrative support, and so forth. We urge the consideration of any further functional consolidation be delegated to a shareholder-elected body, consistent with the above philosophy of management control.

The logic of complementary efforts in both functional consolidation and separation leads to the conclusion that the regulatory function of the FHFB be allocated by statute to a pure oversight and safety and soundness regulator, with the business operations and decisions strictly reserved to the stockholder-representation level. The GSE and agency sector has recently seen some helpful restructurings with the recasting of the Farm Credit System and the creation of the Office of Federal Housing Enterprise Oversight (OFHEO). We support the GAO and HUD reports' conclusion that gains in both operating efficiency and prudential oversight can be achieved by taking the FHLBank System in that direction.

Capital Requirements

The safety and soundness of the System that we would like to preserve and enhance is a major focus of public policy concern. When the Congressional Budget Office report was filed last summer, a great deal of attention began to be paid to both the quality as well as the quantity of the capital underpinnings of the System. The present statutory framework performed in a satisfactory way for more than 50 years and enabled the accumulation of more than $2.5 billion in "permanent" risk capital in the form of retained earnings, mostly locked away in a legal reserve account. The resources were, however, devoted to RTC activities so that new activities are now being considered on a very slim risk capital capacity.

Any accumulation of retained earnings intended to support the existing and expanded activities of the System should be clearly insulated from the risks of being transferred to other purposes. Accordingly, the statutory provisions dealing with capital regime that were adequate for the prior era is now in need of reform. SCBA concurs with the unanimous recommendations of the five reports to Congress that the risk-based approach now applicable to depositories be combined with the customized "stress-test" analysis developed for the other housing GSEs.

The OFHEO is charged, under its 1992 statute, with the imposition and administration of capital standards for both Fannie Mae and Freddie Mac, entities that had been provided with stockholder-elected boards in separate restructurings two decades apart. By statute, those capital standards envisage both leverage and "stress test" components to cover credit, interest rate, and operations risk. One aspect of the charge from the Congress within the framework of studies of the FHLBank System is the appropriate relationship between the capital standard for that system with those for Fannie Mae and Freddie Mac, and the relationship between the GSE standard and those applicable to insured depository institutions.

Obviously, that relationship is both crucial and complex. Predecessor entities of SCBA representing the thrift and community banking sector recognized the special nature of the portfolio and securitization operations of Fannie Mae and Freddie Mac. The scope of their credit enhancement activity, the single-line nature of their basic business operation, and its geographic diversification argue for the special purpose, custom-tailored capital requirement of the GSE statute.

The integration of credit and maturity risk is reasonably well handled in that statute. This is significant because the balance sheets of both these GSEs have grown more than would be strictly necessary to accommodate an increased securitization pipeline. The operations risk surcharge at 30 percent seems more than adequate as an addition to the risk-based measure, on the presumption that the credit and interest risk components are correctly calibrated. This item can of course be reviewed as more experience is gained with that process.

Capital standards of GSEs should reflect differences in business operations. Thus the Fannie/Freddie standards cannot be automatically applied to the FHLBank System. The FHLBanks require substantial excess collateral to secure their advances, plus a pledge of the borrower's FHLBank stock. No loss has ever been incurred on an advance. The risk controls in its lending are one of the factors in the System's "stand-alone" Triple-A rating, which we think is important to preserve.

It is also extremely important to the FHLBank System that capital standards for Fannie Mae and Freddie Mac be correctly set both in absolute terms and in relation to the required level for the FHLBank System. Implicitly, the portfolio lending function that is supported by the FHLBanks competes with the "mortgage banking"/securitization function of Fannie Mae and Freddie Mac. We are gratified that the HUD report paid particular attention to this topic and made a start on the analysis of the impact of the differential capital requirements for portfolio and secondary market lending.

Clearly, for conforming loans, the impetus towards a mortgage banking or participation certificate (PC) swap orientation on the part of FHLBank member depositories is strong. Since that impetus arises from the Basel capital accords, it can be expected to remain for the foreseeable future.

There can be little question that the presence of Fannie Mae and Freddie Mac has compressed yields in the conforming marketplace. Again, the thoroughness of the HUD study is reflected in its serious attempt to address this issue by both original analysis and a critical review of prior empirical studies. Some debate can continue on the speed with which secondary market securitization and the creation of multiple class mortgage-related instruments integrated mortgage finance with national and global capital markets but the reduction in the spread from the Treasury yield curve is undeniable.

Nor is it completely clear how much of the success and growth of the secondary market is attributable to the pure efficiencies of this mode of financial intermediation and how much to the implied federal support from the federal connection of Fannie Mae and Freddie Mac. The sharply divergent level of securitization of the conforming (under $203,150) mortgage market and the higher balance "jumbo" loan may indicate that agency status plays an important role. Also, the growing share of direct issuance of multiclass securities from the GSEs, rather than via Wall Street firms using Fannie Mae or Freddie Mac pass-throughs as "raw material" for the manufacture of multiclass MBS, indicates that even established issuers have great difficulty in succeeding against agency competition.

Secondary market securitization has compressed profits from on-balance-sheet intermediation. But the availability of the securitization swap offers a partial remedy to the problem that securitization itself creates. It enables a lower capital requirement to be assessed since the lender sells the credit risk to the GSEs for the credit enhancement fee.

Many depository institutions have further reacted to the compression of yields by engaging themselves much more extensively in mortgage banking activity. A substantial proportion of the origination activity ascribed to the mortgage banking sector is actually performed by thrift or commercial bank subsidiaries or holding company affiliates. If these originations were added to the values for direct originations by the depositories themselves, the market share numbers that have often been used to depict a sharp decline in the thrift sector share would have to be adjusted upward. In fact, both bank and thrift shares would move up. Many depository institutions now originate all conforming product out of their mortgage banking affiliates and reserve any direct originations strictly for portfolio product.

The FHLBank System that supports those ongoing portfolio operations is clearly overcapitalized from the perspective of support for the business risks addressed by the capital requirements developed for Fannie Mae and Freddie Mac, at least by reference to basic capital ratios.

The HUD study analyzes the arbitrary nature of the capital support for various mortgage intermediation strategies and the capitalization for the System should be considered within that framework. If the conforming loan market is to be almost completely conceded to the securitization activities of Fannie Mae and Freddie Mac rather than coexistence with portfolio lenders, the Congress should at least review the implications of the overall decisions that have led to that result. A careful study of the HUD analysis of that topic would provide a valuable context within which to judge the contribution of the System and of its portfolio lending membership.

The issue of providing a "permanent tranche" within the capital structure of the FHLBank System will also require considerable analysis. SCBA has been engaged in the hitherto internal debate on this topic within the System since the earliest days of the prior FHFB's strategic planning exercise known as "System 2000".

Two reasons for the advocacy of such a permanent component should be distinguished. The first is to address a potential risk, of particular concern to the Treasury, from "System implosion" whereby a loss of membership, and the consequent redemption of their common stock under current law, would concentrate the burden of the REFCorp and AHP contributions on remaining shareholders and prejudice the yield on the remaining stock. This could lead to further departures, and a vicious downward spiral for the System.

Were some tranche of the capital to be permanently paid in, a lower limit would be set on that process which would preserve the sanctity of the System's REFCorp debt service contribution that would otherwise fall on the Treasury. Though mass exodus from the System does not appear to be a realistic concern, assuming prudent management of risk exposure, some such safeguard in the form of permanent capital may be feasible, but it is inequitable and inefficient to maintain a set of disadvantaged, compulsory shareholders to achieve that assurance.

It is also somewhat ironic that the analyses that suggest a value for this permanent tranche frequently produce a figure of around $2.5 billion, the amount that was taken from the System for RTC purposes. Unfortunately, the same dollar cannot serve two masters.

Thus any permanent capital needed for the purpose of expanding the activities of the System is an added requirement: if that capital is needed to cover potential losses, it may not be available to support activities needed to generate an earnings base to cover the annual REFCorp (and AHP) contributions.

The five reports submitted to Congress each discuss in varying degrees the issue of providing a permanent capital base for one or both of the above reasons but did not go into great detail as regards the exact mechanism of this process. SCBA is aware that a capital study group has been formed with representatives of the individual FHLBanks to develop possible capital instruments for this purpose and may engage outside investment banking, accounting, and legal expertise to assist in this task.

SCBA itself has been considering this topic and has already reached two conclusions. First, the cooperative structure of the System should be maintained so that issuance of stock to the public markets should not be a feature of any capital base restructuring. We have convincing experience of the shift in dynamic that is inevitable and appropriate when a GSE "goes public". Both Fannie Mae and Freddie Mac have vigorously pursued market share to the detriment of other mortgage market participants. Again, to the extent that this increase in market penetration is from greater efficiency, other lenders and issuers cannot complain: if it results, even in part, from trading under the GSE label--and it does--an element of unfair intervention is present.

The purpose of the System is to support, not supplant, private portfolio lenders. That purpose would not be furthered by the creation of another widely-owned GSE, or another dozen. Thus, any permanent capital must be provided from a reconfiguration of the existing member/stockholder supplied capital base, not from the general investing public.

We appreciate that this would represent a significant change in the "rules of the game" for stockholders. This permanent tranche (perhaps in the form of non-redeemable common tradeable among members) should be provided equitably by all members with advance notice on the due date of the restructuring. The acceptability of such a reconfiguration to voluntary members would be a valuable discipline on the soundness of any proposed structure.

The second conclusion reached by SCBA's internal deliberations is that any provision of a permanent capital tranche be accompanied by a substantial redemption at par of existing FHLBank stock. This release of capital should be on a "leveraged" basis, e.g., $2 for $1 or better. Critics of the "quantity" of the existing redeemable common cannot have it both ways: if the stock characteristics are not adequate to support present or future activities, it serves no useful purpose and a considerable part of it can be returned to its holders.

SCBA is concerned that some "deal structures" that we have seen envisage an issue of stock to the public. The rate of return projections on those instruments is attractive, largely because very little of the existing common is retired and the rate of return for these member-owned capital instruments is sacrificed to enhance that of new outside shareholders. Such a revision to the capital base would be totally unacceptable and wrong-headed.

SCBA, however, is pledged to continue to work on this issue to develop a proposal that is fair to all stakeholders, that enables the System to extend its scope prudently, and that achieves these goals in the least disruptive way. We believe that one viable approach may be to have the federal safety-and-soundness regulator indicate a range of acceptable capital base compositions for the range of current and potential activities and to grant discretion to the directors of the individual FHLBank to select the appropriate capital structure from that set of regulator-approved possibilities.

Membership Status and Eligibility

As I noted earlier, the membership of my FHLBank is mostly voluntary. The discipline provided by that structure has kept the FHLBank of Boston one of the most efficient in the System. That preponderance of voluntary members has now extended to the System as a whole. It is still important to note, as I discussed above, that the bulk of the stock is still owned by traditional members. Commercial banks (and credit unions) hold only 27% of FHLBank stock.

Even after this switch to mostly voluntary status, it is clear that members once inside the System do not lightly withdraw, but the ability to withdraw and redeem their stock exercises a valuable discipline on the System. Until all members of the System achieve that status, the issue of compulsory membership affects the entire modernization process, from governance to expanded membership to products and services.

We believe that the current basic standards for membership eligibility are completely satisfactory. The statutory language discussing the issues of membership eligibility explicitly emphasizes the "role of the Federal Home Loan Bank System as a support mechanism for community-based lenders". That mission is predicated on membership for those lenders with an ongoing full service commitment to the community via both deposit-based and credit-extension financial services.

Most autonomous mortgage banking operations (by number but not by volume) are thinly capitalized and lightly regulated. The mechanical problems of constructing a collateral perfection process on a constantly shifting loan warehousing inventory would be extremely burdensome and could pose added risk to the System. Those autonomous mortgage bankers that could post substantial capital or collateral, other than the warehousing line, already have adequate financing. Those who do not would be a much riskier credit than anything that the System has hitherto encountered.

To a substantial extent, the mortgage banking sector already has indirect access to the System anyway since, as I noted earlier, many high volume mortgage banking operations are affiliated with depository institutions. All mortgage banking operations can already borrow from member depository institutions. SCBA believes that the unanimity of the five reports submitted to Congress on maintaining the current field of membership should close the debate on this topic.

The most substantial membership problem arises within the current universe of depository institution members since, once inside the System, the rules are not the same for all members. Though some commercial banks have argued that the current membership and capital stock requirements are weighted against them, they have the option to enter or leave as they choose. That is not so for all SCBA members. The current system with its statutory imbalances and contractual membership ambiguities cannot be allowed to persist in the long run. This problem is a major reason for SCBA's insistence on a comprehensive approach to System modernization.

We are confident that the relevant Congressional committees are committed to action in this area, as this very hearing attests. A relevant consideration is the 1993 announcement by the Office of Thrift Supervision that, after a review of its legal authority, state-chartered institutions will not automatically be prevented from exercising their right to leave the System by an OTS assertion of a safety-and-soundness threat. We believe that this OTS policy statement reflects the basic language of the statute that requires only federally-chartered savings institutions to be FHLBank members.

A realistic exit option should be created by this OTS policy when it becomes effective next year but the situation still remains unsatisfactory in that all commercial banks, whether federally chartered (national banks) or state chartered, have fully voluntary status as regards FHLBank System membership. SCBA believes that unnecessary, expensive, and perhaps undesirable charter conversions should not be required to achieve voluntary status for federally-chartered SAIF-insured members.

Once uniform membership eligibility standards are achieved for all members, then, and only then, should stock purchase requirements be equalized and the 30% system-wide limit for borrowing by non-qualified-thrift-lender members be lifted. The restrictions on borrowing if a member falls below the 65% QTL threshold should also be lifted. SCBA concurs with those seeking to liberalize the 30% limit. But we feel that the linkage of issues, as well as basic fairness, agues against such a change in isolation.

Until voluntary membership is universal, risk management in the System must reflect the special status of its mandatory members. A mandatory membership institution should not be subject to risks over which it has no input or control.

Products and Services

The System has very little capacity for additional risk and any new service must be structured to avoid shifting the risk class of its stock toward greater exposure. Potentially significant policy initiatives can be contemplated in the housing and community development arena but they cannot be substantially addressed by the System in its current format. Unfunded mandates should not be imposed on mandatory stockholders.

Any service extension should key off the particular strengths of the System. Thus, we have concluded, as does each of the five mandated studies, that there is no viable FHLB System role in securitizing conforming loans. Fannie Mae and Freddie Mac already cover that market, and the market is well served by the competition between these two GSEs. Also, any new offerings should not cannibalize advances demand since that would be counterproductive. Developing enhanced advances-related products should be the top priority.

We believe that the System may be able to provide some assistance for housing production finance. The needs here are different from those in permanent mortgage finance. Unprecedented volumes of residential mortgage originations have been routinely handled in 1991, 1992, and 1993. The still relatively benign rate environment that could prevail throughout 1994 may produce another record year, not in total volume but in purchase money originations, as stronger economic performance encourages first-time and trade-up buyers to replace some of the decrease in refinance business. For conforming residential loans, the credit availability problem has been solved.

On the production side, however, conditions are not so accommodating. The change in the loans-to-one-borrower (LTOB) rules for thrifts under FIRREA, the threat of stringent real estate lending standards under FDICIA, and the adverse attitude of examiners to real estate credits clearly had a chilling effect.

One role for the FHLBanks that would be consistent with their existing statutory mandate (and with the implications of the areas to be studied in the current report) but that would not impose any additional risk on the System would be to provide a clearinghouse function for overline participations among members to address the FIRREA LTOB limits. Standardization of documentation would provide a real benefit from FHLBank/private sector cooperation and would be consistent with the securitization provisions of H.R. 3474.

The transaction structure could differ from the familiar straight participation in that these deals need not be *pro rata*: some modest cash flow allocations on a last in/first out basis once the LTOB limit can be accommodated on a phased-sale project may be contemplated.

Such a facilitation role for the FHLBanks would also complement the separate agency clarification of the real estate lending examination process. We would be concerned, however, if the System were to be pushed toward a programmatic credit enhancement role in a participations process.

Before any significant steps are taken in these areas, a careful study of the relative risks in the distinct phases of acquisition, development, and construction activity is required. The experience cited by the Office of Thrift Supervision as supporting its initiative reducing required capitalization of construction financing on pre-sold single family residential properties is an obvious starting point. We share the skepticism of each of the Congressionally mandated studies as regards direct lending from the FHLBanks for housing production. The loss experience of Fannie Mae and Freddie Mac in the multifamily market illustrates the dangers of credit extension, enhancement and securitization without the required knowledge base.

Furthermore, we strongly believe that the appropriate role of the FHLBank System is as a facilitator at the "wholesale" level of the lending activities of its "retail" level depository institution members. This concept also extends to the community development and support function of the FHLBanks.

Community Development and Local FHLBank Presence

One of the strengths of the Community Investment and Affordable Housing programs mandated by FIRREA has been the involvement of local lenders and community development groups. That structure also harmonizes with the 1990 Cranston-Gonzales Housing Act and its emphasis on public/private partnerships at the local level.

An aspect of the FHLBank consolidation topic that was to be studied and reported to Congress is the impact of any reduction in the number of FHLBanks on credit availability by geographic area and by income class. SCBA realizes that proximity counts, and we would not support the consolidation of 12 FHLBanks to one location because we do not believe that the stockholders at large are in favor of that structure.

Consistent with the wholesale role of the System, the truly important local market presence is probably that of the member institutions, not the FHLBanks, but we are impressed by the commentary in the analyses accompanying the HUD report to the effect that the local presence and familiarity of the FHLBank community investment officers are major, though intangible, contributors to the success of the AHP and CIP efforts.

As a final matter of comparison and contrast with the other two major housing sector GSEs, we would argue that it would be inappropriate to extend the 30 per cent geographic and low- to moderate-income financing goals now applicable to Fannie Mae and Freddie Mac to the FHLBanks. The FHLBanks already have a different type of quantitative and "hard dollar" burden placed on them via their affordable housing and REFCorp obligations.

The operations of these three GSEs are different: Fannie Mae and Freddie Mac are, basically, credit enhancers. It is a relatively straightforward task to analyze the geographic and income status of the individual borrowers whose credit is ultimately guaranteed.

The portfolio support functions of the FHLBanks are inherently more fungible: do we focus on the collateral that is pledged, the loans purportedly made with advances proceeds, or the loans "really" made possible with that funding access? How do the System and its members get credit for those additional loans made possible by its basic liquidity function? Since money is fungible, we do not see any practical way of attaching "radioactive tracers" to regular advances proceeds to track the percentage flowing to particular borrower segments. For the more limited CIP and AHP funds, such linkage is more clearly demonstrable and, in fact, dollar-to-dollar linkages are required by both statute and regulation via appropriate documentation.

REFCorp Contribution Reform

We do not believe that the approach of the affordable housing obligation should be switched to the percentage requirements set for Fannie Mae and Freddie Mac. We do believe, however, that the burden of the annual $300 million lump-sum REFCorp obligation should be addressed. The structure of this obligation has been a major distraction for the System from its true purpose. The System lost its traditional ability to expand and contract with demand for advances while always keeping the vital community service element of its mission at the top of the management agenda.

The annual $300 million imposition, plus the appropriation by FIRREA of the entire retained earnings of the System accumulated over more than half a century, represents a burdensome and poorly balanced tax on the System. Ideally, that fixed dollar "tax" should be shifted to the 20% flat-rate structure that was the basic concept of FIRREA. The failure of the System and the thrift sector to grow at the unrealistic 7% annual rate envisaged in the underlying economic projections for FIRREA was the factor that elevated the lump-sum $300 million obligation to its recent prominence.

We understand that the switch to a percentage tax, under current earnings projections, could involve a shortfall from the $300 million contribution. We are attracted by the GAO report's suggestion of a "present-value equivalent" approach which would reconfigure the time profile of these contributions but be neutral as regards their economic burden. SCBA is aware of the Pay-Go discipline under the 1990 Budget Enforcement Act (whose term now runs to 1998) but that structure does envision an exception for deposit insurance purposes (admittedly, explicitly only for outlays). This alteration would be consistent with that philosophy, would reduce any future strains on the System if another cyclical contraction were to be called for over the medium term, and could be positioned to have some upside present-value potential for the public purse. Again, however, the mechanics of such a provision are intricate and only a full-scale effort could even begin to grapple with the complications. A variety of attempts to fine tune the allocation of the lump sum $300 million have failed since they did not address the basic structural problem under current law. A bolder solution should be considered.

SCBA has been working on a legislative draft that incorporates all of the issues raised in this presentation. When that effort is completed and moves through our internal policy ratification process, we would be happy to share the work with the relevant Congressional committees and staffs.

Overall, we would certainly prefer a one-time resolution of all the structural issues that the evolution in financial markets has posed for the System. We are concerned that the press of issues facing the Congress may make it difficult to balance the arguments in any legislative initiative dealing with the System right now. We fear that half-measures may be taken that would worsen rather than address our concerns as stockholders. A comprehensive approach, guided by the mass of information produced by the five high-quality studies now submitted to the Congress, will be the most productive strategy.

Thank you for this opportunity to express our views.

Table 1

Non-QTL Member FHLBank Stock Purchase Requirements

		Stock Purchase		
Member Type	Insurer	Initial [1]	Percent of Advances	Other Comments[2]
Savings Associations	SAIF	1% of MRA*	5	1,2
Savings Banks[3]	SAIF	1% of MRA	5/TIP*	3,4
Savings Banks[4]	BIF	1% of MRA	5	
Commercial Banks	BIF	1% of MRA or 0.3% of Total Assets	5/TIP	3,4
Credit Unions	NCUSIF[5]	1% of MRA or 0.3% of Total Assets	5/TIP	3,4
Insurance Companies	---	1% of MRA or 0.3% of Total Assets	5/TIP	3,4

NOTES:
[1] Must not be less than $500.
[2] Other Comments: 1 - Mandatory Membership
2 - Maintenance of 65% TIP ratio
3 - 10% minimum mortgage-to-assets ratio for eligibility
4 - Subject to 30% of System advances limit
[3] Converted to State Charter after FIRREA; now supervised by FDIC.
[4] Historically State-chartered and supervised by FDIC.
[5] National Credit Union Share Insurance Fund.

* TIP is Thrift Investment Percentage, the actual QTL percentage for an institution. The indicated division is performed if the TIP is below 65%, the QTL qualifying threshold.

MRA is Mortgage Related Assets.

Note that the above assumes that the thrift member is automatically QTL-compliant since this is required to access FHLBank advances.

Source: HUD Report to Congress on the FHLBank System, vol. II p. 6 - 2.

Table 2

FHLBank Advances as Institution Funding Source

Member Type	Total Assets	Total Advances	Advances/ Total Assets
Thrifts	$ 770.9 B	$ 75.9 B	9.8 %
BIF Savings Banks	$ 147.1 B	$ 8.7 B	5.9 %
Commercial Banks	$608.8 B	$ 16.1 B	2.6 %

Note: Assets are for members only. "Thrift" assets and advances do not include RTC-controlled institutions.

Data as of March 31, 1994.

Source: Thrift Financial Reports, Bank Call Reports (Ferguson & Co. database)

Issue:	SSC	FHFB	CBO	GAO	HUD
Mission Clarification and Expansion	"wholesale" orientation across all housing levels but possibly more Affordable Housing activities feasible	greater clarity needed: focus on "unmet needs" and emphasize "wholesale" orientation	existing "wholesale" orientation valuable (e. g. IRR management) and minimal additional risk capacity	Affordable Housing the major opportunity area but risk control and selection criteria discipline needed for new activities	substantially added focus on Affordable Housing and Community Development
Membership Provisions a) Field of Eligibility	a) basically same as FHFB	a) maintain current rules: eliminate constraints on banks	a) possibly non-profits	a) only depositories: mortgage bankers specifically excluded	a) maintain existing field of membership with on-going requirement of 10% of assets in mortgage loans
b) universal voluntary	b) yes, but greater emphasis on speed a concern	b) yes, with transition protection	b) generally desirable but REFCorp security	b) highly desirable	b) yes, with transition protection
Capital Composition and Adequacy a) flexible, risk-based	a) yes	a) yes	a) yes	a) yes but linkage to other areas vital	a) yes, but linkage to other areas noted
b) need for "permanent" tranche	b) noted: use of retained earnings or FHLBank stock from member regulatory capital	b) noted: possibly met via retained earnings or other capital instruments issued to members	b) yes: possibly handle via deduction of IRR of System)	b) yes: retained earnings a possibility (e.g. to cover	b) yes: issuance to public an option
c) release of redeemable common	c) yes: subject to capital supplied	c) implicit in above REFCorp obligation security	c) yes: if permanent capital supplied	c) yes: if permanent capital supplied	c) possible, i' permanent cap supplied
REFCorp Contribution Reform a) switch lump sum to flat rate	a) desirable: but no hit to stockholders on shortfall	a) desirable: but no hit to taxpayers is a requirement	a) distortion noted	a) a present-value approach suggested but Pay-Go problem noted	a) distortion no but System h capacity to pa
b) reallocate lump-sum shortfall	b) desirable: no specific recommendation	b) not addressed	b) perverse impact on advances to SAIF members noted	b) yes: switch to assets or capital	b) distortion not but no easy alternative
Investment Activities to meet REFCorp	risks noted: a concern	activities mandated by REFCorp burden	risks noted but CBO not system auditor	risks part of REFCorp distortion	distortion note but need will diminish as advances grov

Issue:	SSC	FHFB	CBO	GAO	HUD
Governance					
a) separation of regulation/management	a) separation desirable	a) conflict built in by FIRREA	a) not specifically addressed	a) yes	a) yes
b) establishment of management coordinator	b) formation of "Central Policy Entity"	b) inherent tension in regional system	b) dependent on any changes in in mission	b) yes	b) possible role for (reduced?) FHFB
c) relocation of federal regulatory authority	c) emphasis on "strong regulator" but no specific shift advocated	c) not addressed	c) not specifically addressed	c) possible merger with OFHEO as new independent agency	c) OFHEO/FHFB merger
Consolidation of FHLBank Districts	FHLBank consolidation only with consent of stockholders	focus on functional efficiency not number of FHLBanks	some savings from overhead reduction: choice of FHLBank a possible discipline on costs	savings to be prompted by market forces from voluntary membership or choice of FHLBank	functional consolidation possibly desirable but concern for local presence, e.g. Affordable Housing

Note: The exact nuances of the discussion and recommendations of each of these reports cannot be fully conveyed in any summary such as that above. The intent is merely to outline, compare, and contrast the studies under the reported categories. At the very least, the Executive Summary of each report should be thoroughly reviewed, though there is no perfect substitute for careful perusal of each of the individual studies. The background work conducted by the FHFB in its System 2000 project also performed some analysis that set the stage for subsequent studies.

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