



Remarks Prepared for Delivery by

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Monday, May 9, 2005

**Independent Community Bankers Conference
Washington, D.C.**

Welcome

Thank you, David [David Hayes, ICBA Chairman] for that kind introduction.

And thank you all for that warm welcome. I'm pleased to join you today to share some of the insights that I've gathered in the four short months that I've been in the regulatory ranks as Chairman of the Finance Board.

Personal History

In listening to my introduction – President of Ginnie Mae, serving at Treasury and HUD and the state government in Oklahoma – you'd think I'm the consummate bureaucrat. But actually, most of my adult life has been in the private sector and I consider myself more of a businessman.

I've never really forgotten my business background. Business and government are two very different worlds. And being "bilingual," able to speak business, while serving in government, has been helpful.

Years ago, I used to be in real estate development in Ohio, Pennsylvania, New York, Indiana, and Florida and I was almost always a customer of community banks.

Critical Role of Home Loan Banks

So I have a real appreciation for what you do and a real appreciation for the role of the Federal Home Loan Banks. The FHLBanks deliver versatile, low-cost funding that helps community bankers like you to meet housing and development needs in your back yard.

And your access to the advance window is critical.

I don't need to tell you that banking has evolved a great deal since the Home Loan Bank System was created 70-plus years ago. The Home Loan Banks, and your banks, have become far more sophisticated in the wake of improved technology and greater competition.

As a result of this evolution, we're also seeing more risk in the Home Loan Bank System.

I fully understand that taking risk is part of business. But in taking risks, an institution must have in place the mechanisms to appropriately and effectively

manage the risk taken. As a regulator, I have a real concern about the corporate governance and risk management shortcomings at some of the FHLBanks. You're probably aware that the Finance Board has entered into two written agreements with the Seattle Bank and Chicago Bank.

And when you couple this with the accounting troubles of their sister government-sponsored enterprises (GSEs), Fannie Mae and Freddie Mac, you'll understand why Congress and the Administration are both pushing for regulatory reform of all the housing GSEs.

GSE Reform

But the question is what is reform likely to look like? Well, in Washington there's no shortage of people with opinions. So I'll go ahead and share mine.

I don't think there's much disagreement about the desire for the GSEs to have world-class regulation. As you know, Congress is likely to put the regulation of all three housing GSEs under one roof, which makes a lot of sense. But the new regulator is going to need the appropriate tools and powers to be effective. After all, he or she will be regulating 14 different entities with combined assets, including off-balance sheet mortgage-backed securities, of about \$5 trillion.

So I support what the Administration and many in Congress are proposing. They want the regulator to be strong and possess the authority to ensure the safety and soundness of the GSEs...and the viability of our housing finance system.

At a minimum, the new regulatory agency should:

- Be independent and funded outside the appropriations process;
- Have the ability to approve new and existing activities;
- Have the ability to set and adjust minimum capital standards – both leverage and risk-based; and
- Have the power to deal with troubled institutions, including receivership powers.

Incidentally, the Finance Board currently has all these powers and it's one of the reasons why it can be effective in supervising the FHLBanks. If there is legislation, I hope it provides for comparable powers over all the GSEs, while giving the regulator latitude to apply the powers as appropriate.

Towards this end, I think it's imperative for the new regulator to recognize the fundamental differences between Fannie and Freddie on the one hand, and the Home Loan Banks on the other. The Home Loan banks are regionally-based, member-owned cooperatives that help fund more than 8,000 member institutions. They are free from many of the pressures of publicly-owned companies and they don't securitize mortgages.

Federal Reserve Chairman Alan Greenspan and Treasury Secretary Snow have said that the new regulator should have the ability to limit the size of the GSEs' mortgage portfolio. I couldn't agree more.

A regulator has to first determine if a business activity truly helps advance a GSE's mission. A GSE's business is its mission. Dividends are not.

So I agree that the amount of mortgages a GSE holds in its portfolio should be limited to what is necessary to carry out its mission.

SEC Registration

Given the size and importance of the Home Loan Bank System and the amount of its debt held by the public, Congress should make SEC registration mandatory for all housing GSEs.

Last year the Finance Board decided that the Home Loan Banks should register with the SEC. I recognize that the registration process has been, and will continue to be, an enormous undertaking. But the FHLBanks are making significant progress.

While registration was initially met with some resistance, in the end it will undoubtedly provide greater transparency and market discipline. I also believe that the registration process has forced the FHLBanks to think a bit differently about investment strategies and their inherent risks.

Supervisory Priorities

Of course, how the Banks manage risk is of great concern to us at the Finance Board. Interest-rate risk is the biggest risk facing the Home Loan Bank System. Consequently, it is at the top of our supervisory agenda.

As many of you know, the Home Loan Banks have grown beyond their traditional role of issuing advances and are now purchasing mortgages from their member institutions. No doubt many of you participate in these programs. But as the FHLBanks have grown in sophistication, so has the complexity of their balance sheets. Each of the 12 FHLBanks measures risk differently, so we are looking at ways to independently measure the FHLBanks' interest-rate risks using a consistent, comprehensive format.

We now require the Banks to submit quarterly reports that show their market-value estimates of assets, liabilities, and shareholders' equity under a range of interest-rate scenarios.

The Finance Board is doing a much better job today on the examinations front. In addition to our annual examinations, this year we started a program to visit each FHLBank on a quarterly basis. These visits also give us the opportunity to determine how far along each FHLBank is with their SEC registration.

As a result of our annual examinations in 2004, the Finance Board placed two of the Banks, Chicago and Seattle, under written agreement – not exactly where you want to be with your regulator. Our examinations found shortcomings with their corporate governance, risk management and internal controls, to name a few.

Corporate Governance

I believe any GSEs has an inherent responsibility to be a model for corporate governance. This starts with a GSE's board of directors. Just as the Home Loan Bank System has changed, so must the composition of FHLBank boards. FHLBanks today need to have an engaged board of directors made up of qualified, knowledgeable, and skilled people. And these individuals should be elected by the members of the FHLBank. Simply put, the regulator should not appoint the regulated.

Predatory Lending

Recently at a hearing before the Banking Committee, Senator Sarbanes asked me why the Finance Board hasn't done more to set predatory lending standards for the Home Loan Banks. I told him that we could, should, and will do a better job. The Home Loan Banks were created for a public purpose. As such they should be at the forefront in ensuring the public that their lending is anything but "predatory."

We all agree that predatory lending is despicable. It also disproportionately affects minorities and immigrants. While minority homeownership is at record levels, it still significantly lags that of white families. We've got to break down the barriers that stand in the way of minorities and new immigrants becoming homeowners.

Our housing finance system must work for all Americans. I'm not suggesting that the Home Loan Banks, or their members for that matter, engage in predatory lending. In fact there are some really good policies in place. But all 12 Banks ought to have a uniform standard that outlines the types of loans that are, and are not, acceptable. This standard should apply not only to the mortgages held in portfolio but also to member loans used as collateral.

I am committed to address this issue, and I realize that the devil is in the details. It's not a question of "if" it will happen, but a question of exactly "how" and "when." I expect that soon we will issue an advisory bulletin that provides FHLBanks with some guiding principles on preventing predatory lending.

I realize that the FHLBanks have a mission to fulfill, members to finance, and a business to run. I understand business. By no means do I want to handicap the System, and community banks like yours, with overly prescriptive regulations. But together we must be able to state without question that predatory lending doesn't have a place in a government-sponsored enterprise.

Rural Lending

Community Banks play a large role in funding agricultural and small business loans. As many of you may know, with the passage of Gramm—Leach—Bliley in 1999, these loans became acceptable forms of collateral for members of the Bank System to access advances.

While some Banks such as Des Moines, Topeka, and Dallas use this authority to increase liquidity for community financial institutions, others appear not to have made much progress. More remains to be done to fully realize the positive economic impact that the Banks can have through the use these expanded collateral powers.

In September, the Finance Board will be holding a one-day symposium here in Washington to explore and discuss this very issue. We hope to better understand why these collateral powers aren't more actively used. Is the problem with supply or demand? I hope you'll join us at the conference because we value your input.

An Effective Finance Board

I consider the Home Loan Bank System a family. It may be a dysfunctional family at times, but it's a family nonetheless. Some people complain about the joint and several liability of the Home Loan Bank System being a weakness, but I really think it is the strength of the System. When the going gets tough, families have to stick together. And despite the problems at some Banks, the System remains strong because of its cooperative structure.

The Finance Board is, I think, a different place today. We've got tremendously qualified and engaged directors. As you may know, the HUD Secretary always has a seat on our board, but in the past Secretaries have often sent a designee. Secretary Alphonso Jackson, who is probably the HUD Secretary with the most housing experience ever, has made a personal commitment to serve on the board himself.

There's a lot more harmony and cooperation at the Finance Board. All too often in the past, politics and personalities got in the way of progress. I depend greatly on my Board colleagues as well as the Finance Board's capable career staff.

Conclusion

There is always room for improvement, but the Finance Board has the tools, the talent, and the expertise to continue its successful track record.

So even if reform doesn't happen this year, the Federal Home Loan Banks will continue to have top-notch supervision. Either way, the Finance Board or the new regulator will have a full agenda and some difficult decisions which will guide the future of our housing finance system.

I don't want to stand in the way of the full agenda that you have today in Washington so I'll conclude my remarks now. Thank you again for inviting me. If we have enough time, I'd be happy to answer a few of your questions.