FEDERAL HOUSING FINANCE BOARD

OPEN BOARD MEETING

Wednesday, October 8, 2003
Washington, D.C.

The Board meeting convened, pursuant to notice, at 10:00 a.m., at 1777 F Street, N.W., Board Room, Washington, D.C.

MEMBERS PRESENT:

JOHN T. KORSMO, Chairman

J. TIMOTHY O'NEILL

FRANZ S. LEICHTER

ALLAN I. MENDELOWITZ

STAFF PRESENT:

ARNOLD INTRATER

MARY H. GOTTLIEB

PAT SWEENEY

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I N D E X

P R O C E E D I N G S

CHAIRMAN KORSMO: This meeting of the Federal Housing Finance Board will please come to order.

Before we get into today's agenda, a very short open meeting agenda, the Government in the Sunshine Act and the Finance Board Regulations require a vote to approve the closed portion of this meeting, which will take place immediately following completion of the open meeting agenda. As the announced agenda states, the closed portion is a periodic update of examination program developments and supervisory findings from the first and second quarters of 2003. The Sunshine Act and Section 522(b)(c)(8) of the U.S. Code and Finance Board Regulations in Section 912.5(b)(1) specifically allow closure of meetings to receive such updates.

This is the third of periodic sessions, during which the Office of Supervision staff will update the Finance Board on our examinations and supervisory program. These sessions include bank examination information that is sensitive and confidential; thus the closed meeting. Both the Sunshine Act and Section 912.5 of Finance Board Regulations require a vote of the

Finance Board to close a portion of a meeting. Section 912.5(b) specifies expedited closure procedures for review of exam programs and findings.

The transcript of this portion of the meeting will, of course, contain information that may be withheld from publication under Section 912.4(a) of our regulations. So at this point I would ask for a motion to both close that portion of this meeting dealing with exam programs and supervisory findings and to seal the transcript and record of this portion of the meeting.

Director Mendelowitz?

DIRECTOR MENDELOWITZ: Mr. Chairman, pursuant to Finance Board Regulations Section 912.5(b), I move to close that portion of this meeting dealing with a review of Finance Board examination programs and supervisory findings, and further, that this Board determine, pursuant to Finance Board Regulations Section 912.5(c)(3), that the record and transcript of this closed portion of the meeting shall be kept confidential pursuant to Finance Board Regulations Section 912.4(a)(8).

CHAIRMAN KORSMO: Well stated. Thank you for the motion.

Is there any discussion of the motion? Any discussion of the motion?

Seeing none, the secretary will please call the roll on the motion.

MS. GOTTLIEB: On the approval of closing the portion of this meeting dealing with examination programs and supervisory findings and sealing that portion of the record and transcript, Director Leichter, how do you vote?

DIRECTOR LEICHTER: Yes.

MS. GOTTLIEB: Director O'Neill?

DIRECTOR O'NEILL: Aye.

MS. GOTTLIEB: Director Mendelowitz.

DIRECTOR MENDELOWITZ: Yes.

MS. GOTTLIEB: Chairman Korsmo.

CHAIRMAN KORSMO: Yes, the motion is carried, and the subsequent portion of our meeting will be closed and the transcript thereof will remain closed and confidential. Thank you.

APPOINTMENT OF TWO MEMBERS OF THE FINANCING CORPORATION DIRECTORATE

CHAIRMAN KORSMO: Let's move to the open part of our agenda. Item number 1 on our agenda is appointment of two members of the Financing Corporation Directorate. Pat Sweeney is making her way to the dias to prepare us for this particular action. Pat?

MS. SWEENEY: Good morning. Thank you, Chairman.

The action presented this morning is routine in nature. It is to consider the appointment of two Federal Home Loan Bank presidents to serve on the Financing Corporation Directorate--that is, FICO--for a term of one year of office, starting November 10, 2003.

FICO is a relic from the 1980s thrift crisis that was chartered on August 28, 1987 by the former Federal Home Loan Bank Board under the FSLIC Recapitalization Act of 1987. It is a mixed-bag ownership, tax-exempt, government corporation owned by the Federal Home Loan Banks. Its primary purpose was to serve as a financing vehicle for the former FSLIC Resolution Fund.

From 1987 to 1989 FICO issued $8.17 billion in 30-year obligations and the proceeds were used to resolve the failed savings and loan associations. Congress terminated FICO's debt issuance authority in 1991, effectively capping FICO's borrowing at the then-outstanding $8.17 billion in obligations. Annual interest payments on the bonds totalled approximately $793 million.

While FICO is subject to the general oversight and direction of the Finance Board, its operations are under the management of a three-member Board designated as the FICO Directorate. The managing director of the Office of Finance is one of those individuals on the Board, in addition to two members who are selected from among the Bank Presidents of the 12 Banks.

According to statute, each Bank President is appointed for a one-year term and no Bank President is appointed for any additional term until each of the other banks has served as many terms on the FICO Directorate as the President of such Bank.

Under an informal agreement between the Bank Presidents and the former Bank Board reached in 1987, the sequence of appointments was initially based on seniority of Bank Presidents. The Bank President selection process for the FICO Directorate appointments is now in its third rotation cycle. The initial rotation cycle was completed November 9, 1993. Upon completion of the first rotation cycle, the Finance Board established a second rotation cycle, initially giving priority consideration for appointment to those individuals who had yet to serve on the FICO Directorate. While seniority continued to be a guiding priority, the rotation cycle was adjusted to avoid overlapping appointments with the FICO Directorate.

The second rotation cycle was completed on November 9, 1999. Charts that show the exact rotation cycle with names are provided to you in your Board Package on page 2.

We are currently approaching the end of the third rotation cycle, as shown on page 3 of your Board Package. Six Banks have completed representation on FICO and two Banks are about to complete representation as of November 9 of this year. Those are the New York Bank and the Cincinnati Bank.

With that, only four Banks will remain outstanding in this cycle: Topeka, Des Moines, San Francisco and Pittsburgh. Staff is proposing to continue to follow the established rotation cycle by appointing Bank Presidents from Topeka and Des Moines to fill the appointments. Neither of these individuals has conflicting appointments with the REFCORP Directorate.

Accordingly, with the terms of the two current FICO Directorates expiring on November 9, 2003, staff recommends the appointments to the FICO Directorate of Andrew J. Jetter from Topeka and Patrick J. Conway from Des Moines. Neither Bank has been represented on FICO during this third rotation cycle. This recommendation is made in compliance with statutory requirement that no Bank President be appointed for an additional term until each of the other Bank Presidents has served as many terms on the FICO Directorate as the President of such Bank.

With that, are there any questions?

CHAIRMAN KORSMO: Any questions for Ms. Sweeney? Any questions?

If not, thank you very much, Pat.

The chair would entertain a motion to approve Andrew J. Jetter of Topeka and Patrick J. Conway of Des Moines to serve as Directors of the Financing Corporation.

DIRECTOR MENDELOWITZ: Mr. Chairman, I so move.

CHAIRMAN KORSMO: Director Mendelowitz.

Director Mendelowitz has moved appointment of Mr. Jetter and Mr. Conway. Is there any discussion of the motion? Any discussion of the motion?

Hearing none, the secretary will please call the roll.

MS. GOTTLIEB: On the appointment of Andrew J. Jetter of Topeka and Patrick J. Conway of Des Moines to serve as Directors of the Financing Corporation, Director Leichter, how do you vote?

DIRECTOR LEICHTER: Yes.

MS. GOTTLIEB: Director O'Neill?

DIRECTOR O'NEILL: Aye.

MS. GOTTLIEB: Director Mendelowitz?

DIRECTOR MENDELOWITZ: Yes.

MS. GOTTLIEB: Chairman Korsmo.

CHAIRMAN KORSMO: Yes, the motion is carried. Andrew Jetter and Patrick Conway are appointed to serve as directors of Financing Corporation.

The responsibility falls to the chair of the Federal Housing Finance Board to name a chair of the FICO Corporation. It is my intention to name Mr. Jetter chair, to serve as chair of the Financing Corporation.

Thank you, Pat.

APPOINTMENT OF A DIRECTOR

FEDERAL HOME LOAN BANK OF INDIANAPOLIS

CHAIRMAN KORSMO: Item number 2 is appointment of a Director to the Board of Directors of the Federal Home

Loan Bank of Indianapolis, a Public Interest Director-- excuse me. There's a vacancy in the Public Interest Director slot on the Board by virtue of the resignation of Shirley Johnson, State Senator Shirley Johnson of Michigan. I am recommending to the Board the appointment of Robert T. "Bob" Grand to fill out the unexpired term, which I believe runs until December 31 of 2005, is that not correct, of Ms. Johnson's term, Senator Johnson's term.

All of the members of the Finance Board have had a copy of Mr. Grand's resume. As you know, he's managing partner of the Indianapolis office of the law firm of Barnes and Thornberg, where he's a member or the governmental services and finance department. His area of specialty is in public finance and governmental regulation. He has served as an advisor to the Indiana Housing Finance Agency, has extensive experience in any number of boards, again which I think all of you are familiar with.

And so it is my intention to nominate Mr. Grand to serve out the unexpired term of Senator Johnson.

Are there any other nominations for this position? Are there any other nominations?

Seeing none, the secretary will call the question on the appointment of Robert T. "Bob" Grand to serve as a Director of the Federal Home Loan Bank of Indianapolis.

MS. GOTTLIEB: On the approval of the appointment of Robert T. Grand as Public Interest Director to the Board of Directors of the Federal Home Loan Bank of Indianapolis, Director Leichter, how do you vote?

DIRECTOR LEICHTER: Yes.

MS. GOTTLIEB: Director O'Neill?

DIRECTOR O'NEILL: Aye.

MS. GOTTLIEB: Director Mendelowitz?

DIRECTOR MENDELOWITZ: Yes.

MS. GOTTLIEB: Chairman Korsmo.

CHAIRMAN KORSMO: Yes. Robert T. "Bob" Grand is appointed to serve as a public interest director on the board of the Federal Home Loan Bank of Indianapolis to serve out the term expiring December 31 of 2005. We will notify Mr. Grand of his appointment.

Yes, sir?

DIRECTOR O'NEILL: One thing, and I said this--

CHAIRMAN KORSMO: We're going to find that he was a close personal friend of Mr. O'Neill?

DIRECTOR O'NEILL: No, no. I said this during the briefing, but I don't know how this happened, but until this appointment there were in the two states that make up the Indianapolis District there were five from Michigan and only one from Indiana. So I think this is great that we are finally getting a little balance back in the district. So I really thank you, Mr. Chairman, so that Michael Hannigan doesn't have to be out there all alone, we now have another Hoosier on the Board. So thank you very much for that.

CHAIRMAN KORSMO: I'll remind you of that statement when we make appointments to the Federal Home Loan Bank of Des Moines, and I'm hoping there might be a North Dakotan whose name will appear at some point. Thank you, Director. I appreciate your comments.

FINAL RULE REGARDING THE

PRIVACY AND FREEDOM OF INFORMATION ACTS

CHAIRMAN KORSMO: Item number 3 on our agenda is a final rule regarding the Privacy and Freedom of Information Acts. Janice Kaye will be presenting this agenda item. Janice?

MS. KAYE: Thank you. Good morning.

Before you today is a final rule implementing the Privacy Act of 1974 and adjusting the fee schedule in the Finance Board's Freedom of Information Act rule.

At the June 2003 board meeting, the Board approved publication in the Federal Register of an interim final rule revising the Privacy Act regulation, which had not been updated since 1993.

The new Privacy Act rule is written in a user-friendly format using plain language and where appropriate, a question-and-answer format. It reflects a reassignment of responsibility and authority for the agency's Privacy Act program to the Office of General Counsel.

The interim final rule also amended the Freedom of Information Act fee schedule to take into account increased salary and operational costs. We determined the amount of the fees for duplicating records under the Privacy Act in accordance with the FOIA fee schedule.

The 60-day comment period for the interim final rule closed on September 2, 2003 and we did not receive any comments. So what we have before you is a final rule that adopts the interim final rule without substantive change.

The only change is a technical one, redesignating Section 913.7(c)(1)(vii) as 913.7(c)(1)(vi).

CHAIRMAN KORSMO: Okay.

MS. KAYE: I'd be happy to answer any questions about the rule.

CHAIRMAN KORSMO: Are there any questions for Ms. Kaye?

DIRECTOR MENDELOWITZ: The fees that are collected from, I guess applicants--how do you describe someone who files a FOIA request?

MS. KAYE: A requester.

DIRECTOR MENDELOWITZ: A requester. The fees collected from a requester go into our agency funds and are used to reimburse us for the cost of responding to the request?

MS. KAYE: That's the intent, yes. We assess fees in very few cases. There's a threshold for assessing fees.

DIRECTOR MENDELOWITZ: There’s a de minimis?

MS. KAYE: For most requests we handle there is no fee assessed.

CHAIRMAN KORSMO: Are there any other questions? Any other questions?

Hearing none, the chair will entertain a motion to approve the final rule regarding the Privacy and Freedom of Information Act provisions.

DIRECTOR LEICHTER: So moved.

CHAIRMAN KORSMO: Director Leichter.

Is there any discussion of the motion? Any discussion of the motion?

Hearing none, the secretary will please call the roll on the question of adoption of the final rule.

MS. GOTTLIEB: On the approval of the final rule amending the Finance Board's Privacy Act and Freedom of Information Act regulations, Director Leichter, how do you vote?

DIRECTOR LEICHTER: Yes.

MS. GOTTLIEB: Director O'Neill?

DIRECTOR O'NEILL: Aye.

MS. GOTTLIEB: Director Mendelowitz.

DIRECTOR MENDELOWITZ: Yes.

MS. GOTTLIEB: Chairman Korsmo.

CHAIRMAN KORSMO: Yes, the motion is carried. The final rules are adopted. Thank you very much, Janice. We appreciate it, appreciate your hard work on this. I know this was not an interesting topic. Glad someone else is working on it.

Before we break to go into the closed portion of the meeting let me bring to your attention a news release the Finance Board posted yesterday in cooperation with nine other federal agencies. Several years ago these agencies formed the Federal Interagency Task Force on Fair Lending to coordinate efforts, particularly educational efforts, against predatory lending. Yesterday we joined them in posting on our web site a new brochure, "Putting your Home on the Loan Line is Risky Business." It's an informative publication about home equity loans that cautions, and I'll read from the release, "that regardless of whether a home equity loan is for a home repair, bill consolidation or some other purpose, it is important to shop around."

The brochure includes a work sheet to help folks do comparison shopping for a home equity loan and it offers other good information for consumers. I've provided copies of the brochure to each director and the agency has available some 500 copies we will distribute to the Federal Home Loan Banks.

As you know, many of the banks have undertaken serious reviews of their lending policies with respect to predatory lending, even though, of course, they're not in the direct business of making home mortgages. For example, the Federal Home Loan Bank of Atlanta adopted guidelines to promote responsible lending, including restrictions on the kinds of collateral members may use to support advances, as well as prohibitions on acquiring certain privately issued mortgage-backed securities.

You'll also recall that in our proposed AMA revision the Finance Board sought public comment on whether it should take measures to prevent a Bank from acquiring loans or assets backed by loans through its AMA program if the loans have certain features or were made under circumstances that might be considered predatory or abusive.

As staff continues to work to revise the proposed regulation, I certainly believe that the provision seeking public comment on predatory lending should be retained. I know that I am, and I know you are, Director Leichter, keenly interested in the public's thoughts about steps to prevent predatory or abusive lending by financial institutions, so I thought we'd bring this new publication to everyone's attention. Thank you.

With that, is there any other business to come before the open portion of the meeting? Director Mendelowitz?

DIRECTOR MENDELOWITZ: I think you were going to raise an issue regarding retained earnings.

CHAIRMAN KORSMO: I thought you were going to raise it.

DIRECTOR MENDELOWITZ: Okay. Mr. Chairman, as you and the other members of the Board know, since I've arrived at the Finance Board, one of my primary objectives and concerns has been to encourage a system to build the appropriate level of retained earnings on the balance sheets.

I have to say this was an easy sell amongst my colleagues on the Finance Board. I think that all of us have joined in together in recognizing and stressing the importance of building the appropriate level of retained earnings at each Federal Home Loan Bank.

This has been a harder sell amongst the banks. Some of them have recognized early on the importance of this and have adopted specific policies to build retained earnings to reflect the appropriate level commensurate with the risk on their balance sheets. Others have lagged behind.

The Supervision staff has executed on the view of the Board with respect to retained earnings with an Advisory Bulletin, 03-08, which instructs each of the Banks of the importance and necessity of doing an assessment of the appropriate level of retained earnings and then putting in place a plan to build retained earnings to the appropriate level, as determined by their analysis.

I can't stress the importance enough of this advisory bulletin because it makes the point that retained earnings necessary to implement the appropriate level of retained earnings on the balance sheet should represent a first claim on the profits of the bank and not a residual after dividends are adopted. Clearly there should be an analysis of the appropriate level of retained earnings. As the supervisory bulletin lays out, there should be a plan to achieve the appropriate level and that the dividends actually paid out should be a residual after a set-aside is made for the appropriate level of retained earnings.

CHAIRMAN KORSMO: Not the other way around.

DIRECTOR MENDELOWITZ: Not the other way around, exactly.

And I think it's also important to stress that the importance of retained earnings really falls into a couple of categories. The adoption of FAS 133 by the Financial Accounting Standards Board created an increased fluctuation in income from quarter to quarter based on the asymmetrical way in which different assets are treated on the balance sheets of the banks. Over time, these fluctuations cancel out but from quarter to quarter there can be a significant variation in profits that are the result of an accounting artifact, rather than any real change in profitability.

So clearly the Banks need a certain level of retained earnings to smooth out the ability to pay dividends when real income, in fact, hasn't changed. There is, although, a need for a second category or second pot of retained earnings and those retained earnings should be achieved and realized based on an assessment of the risk on the balance sheet, both of the credit risk, which for the most part is fairly modest, but primarily tied to the interest rate risk on the balance sheet.

The expectations of the members is that because we have par value stock, there's no capital gains associated with them, the expectation is short of an extrema situation in which, God forbid, a Bank should collapse, members don't really expect to see a hit taken against the capital. And therefore, retained earnings are absolutely critical to absorb losses that may arise from time to time on the balance sheet.

Sometimes when staff sends out a notice, the banks may not appreciate how wholeheartedly that direction from the staff reflects direction from the Board of Directors and I think it would be worthwhile for us today to join in in expressing our view that the Home Loan Banks should immediately implement Advisory Bulletin 03-08, clearly understanding that all the banks have to have an analytical basis for determining the appropriate level of retained earnings, they have to have a plan in place to build those retained earnings, and certainly over a reasonable time period--for example, 12 months is laid out in the bulletin--and that there is no confusion as to the importance that the Finance Board places on this. I guess we could put a formal resolution in but I think our purposes could be served with just a voice vote expressing our support for the Advisory Bulletin 03 and the view of the Finance Board that in view of the importance of retained earnings, that no dividends going forward be paid out of any retained earnings currently on the books of the Banks until the assessment of the appropriate level of retained earnings is completed and the plan is adopted to build retained earnings to the appropriate level.

CHAIRMAN KORSMO: I think a voice vote on that point would certainly be appropriate. I guess I was concerned to learn today that another Federal Home Loan Bank, the same day they're announcing they're going to experience a $9 million plus loss in the third quarter, albeit a FAS 133 loss, nevertheless the same day announces they're going to pay $30 million plus in dividends. And again this action was taken prior to the Bank having conducted the assessment that our Office of Supervision has asked them all to conduct.

I certainly think it's an appropriate action to take in terms of expressing our support to the Office of Supervision in this regard. Is there any comment from any other director on this, on Dr. Mendelowitz's suggestion? Director O'Neill?

DIRECTOR O'NEILL: I think this is important enough that we might, rather than a voice vote, ask the secretary to call the roll so that we all individually, our vote in favor of this is on the record.

CHAIRMAN KORSMO: Let's refer the question to our general counsel. I notice he had his hand up.

MR. INTRATER: Yes, I just wanted to confirm that since this was not put on the schedule for this open portion, the Board will first have to vote on making the addition of this subject matter in the open session. Once you vote to do that, then you can go ahead with the motion.

CHAIRMAN KORSMO: I have no problem with that. The only other concern I have is Director Weicher is not here and I suspect he would like to make his feeling known, as well, on this issue, so maybe we should stick with a voice vote expressing our concern if that's all right.

DIRECTOR O'NEILL: Okay.

CHAIRMAN KORSMO: Is there any other comment? Dr. Mendelowitz?

DIRECTOR MENDELOWITZ: Mr. Chairman, I think that the message has been sent by the unanimous support that the board has expressed for the timely implementation of Advisory Bulletin 03 and the importance of doing this before any dividends are paid out of any existing retained earnings.

And I would suggest that maybe just to speed the process along and not get too tied up in formality, that maybe if you were to write a letter to the Presidents of the Banks and the Chairs and Vice-chairs of each of the Boards of Directors pointing out that this matter was discussed at the Board meeting, that there was unanimous support amongst the Board of Directors for the implementation of Advisory Bulletin 03-08, and that the view of the Board is that no future dividends should be paid out of retained earnings until the exercise has been completed so that we have assurance that each Bank is moving toward the appropriate level of retained earnings.

CHAIRMAN KORSMO: Do the other members of the Board support that action? I see--

DIRECTOR LEICHTER: Yes.

CHAIRMAN KORSMO: We'll note for the record we have heads nodding yes in every regard.

Thank you, Director Mendelowitz, for bringing this to the attention of the Board. It's an extremely important topic and I will take your suggestion to heart and write correspondence to each of the 12 Boards and Presidents reflecting the concern that this Board has for immediate implementation of the advisory bulletin.

Are there any other topics to come before the Board? Any other items to come before the Board?

Seeing none, in accordance with the vote we took at the start of today's meeting, we will now go to the closed portion of our meeting to discuss examination supervisory programs.

Why don't we take a five-minute recess in the hope that Director Weicher can get here?

[Whereupon, at 10:28 a.m., the open portion of the meeting concluded.]