



NEWS

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FHFB CHAIRMAN CASTANEDA'S REMARKS TO A FORUM ON FEDERAL HOME LOAN BANKS

The following are remarks prepared for delivery Alicia R. Castaneda, Chairman of the Federal Housing Finance Board, at a forum on the Federal Home Loan Banks.

Thank you all for the warm reception. I certainly appreciate it, and I congratulate all of you at ACB, the ABA, ICBA, the Roundtable and the Council, for putting this forum together. I hope it will prove a good opportunity for the Federal Home Loan Banks and their members to not just raise issues, but also to make some concrete progress in resolving them and moving forward productively for the benefit of the Federal Home Loan Bank System.

I do appreciate the invitation to speak to all of you here today about my views on major issues facing the Federal Home Loan Banks. And thank you so much for accommodating my schedule – I do have to leave soon, for which I apologize, and you were very kind to arrange the agenda so I could still speak. As I have said since I first joined the Board, I think it is important that we at the Finance Board and you in the System have open lines of communication. So I and the other Finance Board staff who will also be participating are glad to be here.

And, before I begin, I must also note of course that I am speaking for myself today, not for the Federal Housing Finance Board or any of my colleagues.

Since this is the first time I have had the honor of speaking before all of you, allow me to tell you all just a little bit more about Alicia Castaneda.

First, I am a banker. I spent 28 years in banking before coming to the Finance Board, starting with American Security Bank not so far from here.

As many of you know from your own personal experience, if the financial services industry over the years has seen any one constant, it has been "change." My career certainly attests to that. Over the years, I held a number of posts, went through several mergers, and ultimately served as Senior Vice President, Private Banking, for Bank of America and Bank of America Investment Services, before being named to the Finance Board.

I think that having lived through all those changes gives me a valuable perspective on many critical issues facing the Federal Home Loan Banks. It's a perspective that many of you would understand or even share, I think. In fact, I was somewhat astonished when I learned that I am the first banker to ever have served as Chairman of the

Federal Housing Finance Board. So I understand what it is that you do for a living. And I understand change.

Change, of course, is a constant when it comes to regulation, too. As the Federal Home Loan Banks continue to evolve in response to the needs of their members and the financial marketplace, the Finance Board encounters new issues...new challenges. We, like the Banks, must evolve as well.

Your trade associations have organized today's forum to address some of these significant changes facing the Federal Home Loan Banks. This forum provides a valuable platform for sharing thoughts, perspectives and concerns, and I hope it helps everyone better understand these changes and the best ways to move forward in the long-term interests of the Federal Home Loan Bank System.

One of the changes I am referring to is, of course, registration of the Federal Home Loan Banks under the Securities Exchange Act of 1934.

I see that you have a panel discussion this afternoon about Finance Board rule-making. So, rather than talking about process, I would like to say a little bit more about the reasons why SEC registration is a priority for the 12 Federal Home Loan Banks, their members, and the public, and to give you my own thoughts behind my vote for registration.

I am especially pleased to see Alan Beller of the SEC will be one of this afternoon's panelists. As you well know, both the Finance Board and the Federal Home Loan Banks worked closely and at some length with Director Beller and his staff prior to the June vote on SEC registration.

I know he was instrumental in helping the Finance Board in our deliberations to answer questions, evaluate options and resolve problems. I think the Federal Home Loan Banks who have dealt with the SEC's Division of Corporation Finance and Office of Chief Accountant will tell a similar story.

And I expect that he will likewise help those of you here today to better understand the SEC's positions and intentions, and the realities of the registration process for the Federal Home Loan Banks.

I also want to stress – because I think it is very important – that as the Banks' safety and soundness regulator, the Finance Board has had, and will continue to have, ongoing involvement and dialogue with the Banks and the SEC about issues of interest to the Federal Home Loan Bank System.

I have instructed a group consisting of Finance Board examiners, accountants, and attorneys to work with the SEC and the Banks both during and after the registration process, to ensure that the Banks meet the requirements of registration while continuing to operate in a safe and sound manner, have access to the capital markets and carry out their housing finance mission.

Please understand that I do appreciate your embrace of the principle of enhanced disclosures. I also appreciate your strong advocacy, which helped staff and the Board address issues that needed to be addressed.

Which we did. After thorough analysis by Finance Board staff and Board members, these issues were addressed – the legal questions, the accounting issues and the policy considerations.

And the Finance Board reached a decision. In June, as you know, we voted unanimously to require the Home

Loan Banks to register with the SEC under the Securities Exchange Act of 1934.

All 12 Banks must submit their first filing to the SEC by June 30, 2005, and those registrations must become effective by no later than August 29, 2005.

As a regulator, the Finance Board determined that registration under the 1934 Act is in the best interests of the Federal Home Loan Banks, and was satisfied that the significant Systemic issues that needed to be resolved were in fact resolved to the Finance Board's satisfaction. Now, as part of the normal registration process, the Banks are engaging in discussions with the SEC so that any Bank-specific issues can be raised and addressed well before the deadlines specified in the Finance Board's rule.

The Finance Board is closely monitoring and is very engaged in this process, I can assure you.

We have also instructed the Banks to keep us informed about their progress – and we do expect progress. We will be following up regularly. There is no turning back.

I should note that in my discussions with members of Congress and their staffs, the response to registration has been supportive and quite good. We did receive many questions, which we were able to answer to people's satisfaction. To me, it appears that Congress is still interested in corporate governance issues in the wake of Sarbanes-Oxley, an environment in which SEC registration represents a major step forward.

To state the obvious: All of you know that the Federal Home Loan Banks are among the biggest debt issuers in the country, issuing roughly \$500 billion in bonds annually in recent years.

Given the size, growth and complexity of the Federal Home Loan Banks, it became a priority to move toward disclosures that provided more information to member financial institutions, the public, and investors. This need for transparency was a basic principle arguing for improved disclosures.

In my personal decision-making, I also placed a great deal of weight on safety and soundness. As the Basel Committee and many other regulators have concluded, enhanced disclosures provide important benefits for safety and soundness. Consistent and transparent disclosures help achieve market discipline because investors in that market know more about the risks faced by the financial institutions in question. Market discipline, in effect, supplements the safety-and-soundness oversight of the Finance Board.

Another critical issue concerned the proper role and responsibilities of GSEs, especially given the recent, heightened attention to corporate governance. The public, investors and policy-makers have become more demanding, and rightfully so.

To meet those demands, my colleagues and I unanimously concluded the Federal Home Loan Banks should be recognized as world-class leaders in transparency, disclosure and corporate responsibility, especially because they are GSEs, created by Congress to serve a public purpose. We considered the possibility of creating a disclosure regime within the Finance Board, but concluded that it would be more appropriate for us to require the Banks to register with the SEC.

The SEC, as the nation's functional disclosure regulator, has the expertise in disclosure and accounting issues. To develop the Finance Board's resources in this area would distract from the Finance Board's core emphasis on

safety and soundness and mission oversight. As I will describe in just a moment, our oversight capabilities have dramatically improved, and I did not want to shift the focus away from that emphasis.

The final decision for SEC registration was heavily influenced by the central issue of comparability. Federal Home Loan Bank disclosures should be fully comparable to other entities with whom they compete for funds in the market, especially the two other housing GSEs. Just as important, investors must accept these disclosures as comparable.

And where is that comparability to be found? At the SEC.

As I mentioned, I was a banker. I've sold agency debt, including Federal Home Loan Bank COs. I know first-hand that if disclosures are not comparable – if there's even a slight doubt in the investor's mind that your disclosures are not on the same level as other issuers in the market – you've lost confidence. As an issuer, your spreads widen, you find yourself chasing the market, and your cost of funds will rise. Your ability to “raise funds in the capital markets” will be compromised, at the very least.

This was an essential consideration for me, and it should be for you, too, as members who rely on the Federal Home Loan Banks for low-cost liquidity.

In the end, the case became clear to all of us on the Finance Board. Enhanced disclosures are necessary as a fundamental policy and safety-and-soundness matter. As the acknowledged, world-class expert in financial disclosures – with all the expertise and personnel -- the SEC was the right place to make those disclosures.

Perhaps most importantly, combined with the improved safety and soundness oversight conducted by the Federal Housing Finance Board, SEC registration will help support the reputations of the Federal Home Loan Banks as solid, capable, respected financial institutions. Reputation counts for so much in the financial services industry, as all of you know.

And I think we should all bear that in mind. In today's corporate governance environment, there is a clear reputation risk in being perceived as saying, as some may characterize it, “We are FOR enhanced disclosure...but only sometimes...and only on our own terms.” I do not believe it is in the interest of the Federal Home Loan Bank System to court that risk.

Fannie Mae has already registered. Freddie Mac is committed to doing so. And, now, so will the Federal Home Loan Banks.

Now, again, certain limited accommodations reflecting the unique nature of the Federal Home Loan Bank System can be explained to the markets and fully supported on policy grounds. But I and my colleagues believe those necessary accommodations HAVE, in the case of the Finance Board, already been made and, in the case of the SEC, the intention to make them has been clearly and publicly stated.

My sense is the Banks are on board. And I hope that, if any of you are not yet on board, this forum will help you find common ground and do so, as well. As the process toward registration continues, members may have further questions or concerns.

In some cases, it may be appropriate for the Finance Board to address them. In many others, though, you may find

it more useful to talk directly with your respective Federal Home Loan Banks, particularly in this current phase where it is the individual Banks that must now work with the SEC to register. But, rest assured, the Finance Board will remain engaged, my door is always open, and I am always glad to hear from my friends from all of your trade associations.

I'd like to turn now to another change affecting the Federal Home Loan Banks: the Finance Board's continuing, determined efforts to build a strong, independent, and credible regulatory agency. The Federal Home Loan Banks and their housing-finance mission can only be helped by having a federal regulator that is serious about safety and soundness oversight. And we are serious.

Today, I can say with full confidence that the Finance Board is fulfilling the duties Congress gave it in the Federal Home Loan Bank Act: To ensure that the Federal Home Loan Banks operate in a financially safe and sound manner, carry out their housing finance mission, and remain adequately capitalized and able to raise funds in the capital markets.

Over the past two years, the Finance Board has made great strides in enhancing our capabilities to carry out these duties. The clearest evidence can be seen in dramatic growth of our examination staff – our highly qualified examination staff.

However, bank supervision is more than just examinations. We have been building toward a team approach to supervision.

In addition to our examiners, we have hired highly qualified mortgage specialists, bank analysts, community development specialists, accountants and economists. We are upgrading our technology and systems. Working together, these experts can and do all contribute significantly to our oversight and supervision of the Federal Home Loan Banks.

Let me provide you just a little more detail. We are wrapping up the budget process for the year; the Board is scheduled to vote on the final document on tomorrow.

In the next fiscal year, which starts in October, our goal is to substantially increase the resources in our Office of Supervision. Those are the people who do all the analysis, on-site and off-site examinations, the essential work of oversight and supervision.

Under the budget currently before the Finance Board for approval, our budgeted Supervision staff would grow 20 percent, from 80 this year – although not all the jobs are currently full – to 96 in Fiscal Year 2005, including 40 examiner slots, two additional positions in our exam policy and accounting group, and another three in risk monitoring.

So now, after several years of steady improvement, I think we have the staffing and expertise needed to effectively use the team concept in our examinations.

You, as members of the Federal Home Loan Banks, understand that the Home Loan Banks are different – not only from other institutions, but also from each other. They feature different risk profiles, different business strategies, different portfolios. Some focus more on making advances, others are more active in acquired member assets.

Because Banks are different, we need our people to specialize, to become intimately familiar with individual banks and their operations. Now, after several years of steady improvement, we have the staffing and expertise to effectively function with these specialized teams.

For that very reason, we have developed and formalized our team approach toward specialized Bank examinations, selecting examiners in charge through a competitive process and adding portfolio managers, as well, to further enhance the consistency, quality and competency of our examinations.

The way I see it, our job is to address problems as they arise, of course. But, more importantly, I also want this agency to more aggressively look for ways we can be sure we address them before they become too big to handle. That is my personal goal.

So I hope you can recognize that we are serious – very serious -- about fulfilling the safety and soundness and mission duties that Congress has assigned the Federal Housing Finance Board. You can see it in our recent regulatory efforts; you can see it in our recent guidance and communications with the Federal Home Loan Banks on important safety and soundness issues like capital management and risk management. Today's Finance Board is doing exactly what a 21st Century financial regulator should do.

Finally, I did not have the benefit of hearing from your morning guests, but imagine the broader topic came up about the proper regulatory structure for the housing GSEs – Fannie Mae, Freddie Mac and the Federal Home Loan Banks. I have maintained a neutral position on this question, believing that it is a policy question best left up to the Congress.

I also have to confess that I lack any special powers of prediction when it comes to Congressional action, although obviously most observers – including the ACB, I see – think it will be difficult to resolve these issues this year.

But, in the meantime, you can be sure of this: The Federal Housing Finance Board is a serious and effective safety-and-soundness and mission regulator. Even if a new regulator is created in the future, that regulator will acquire a talented, dedicated and skilled staff, one fully capable of continuing the rigorous oversight program we have put in place for the Federal Home Loan Banks.

Another way of putting it is to simply say, we are vigilant. And our vigilance is good for the Federal Home Loan Banks, their members, the public, and for you. I hope you agree.

Thank you so much for the opportunity to visit with you today. Best of luck with the rest of the forum.

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