

IN THE FEDERAL HOUSING FINANCE BOARD

IN THE MATTER OF:)
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 OPEN MEETING)
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Second Floor Board Room
 Federal Housing Finance Board
 1777 F Street, N.W.
 Washington, D.C. 20006

Wednesday,
 April 12, 2000

The parties met, pursuant to the notice of the Chairman
 at 10:12 a.m.

PRESENT:

- Bruce A. Morrison, Chairman
- William C. Apgar, Director
- J. Timothy O'Neill, Director
- James L. Bothwell
- William W. Ginsberg
- Ellen Hancock

- 1 Eric Raudenbush
- 2 Deborah F. Silberman
- 3 Scott Smith

P R O C E E D I N G S

(10:12 a.m.)

CHAIRMAN MORRISON: Okay. The meeting will come to order. We have one item on the agenda, a very substantial one at that, though. And this is the proposed rule on authorization to acquire member assets and a definition of core mission activities.

Mr. Ginsberg.

MR. GINSBERG: Mr. Chairman, thank you. Members of the Board, good morning. This proposed rule builds on the definition of the mission of the Federal Home Loan Banks that the Finance Board adopted at its last meeting last month by proposing a definition of what constitutes, and by extension, of course, what doesn't constitute, core mission activities for the Federal Home Loan Banks.

This proposed rule also would propose to authorize as a product of the Federal Home Loan Bank System, "acquired member assets", which is a newly defined term set forth in the proposed rule which is an outgrowth of the success of the mortgage partnership finance pilot pioneered in Chicago and now undertaken by more than half of the Federal Home Loan Banks. And this proposed rule would finally propose to define authorized and prohibited investments for the Federal Home Loan Banks on a going forward basis.

All of this grows out of the FMMA, the Financial Management Mission Achievement regulation proposed last year

1 by this Board and ultimately withdrawn in light of the
2 legislation. So this is somewhat different, although largely
3 substantially similar ways of dealing with the same issues in
4 light of Graham-Leach-Bliley and all of the changes in the System
5 that have taken place as a result of Graham-Leach-Bliley.

6 I would ask Scott Smith, deputy director of the Office
7 of Policy, Research, and Analysis to describe the proposed rule
8 in detail. Scott.

9 MR. SMITH: Thank you, Will. Good morning, Mr.
10 Chairman and directors Apgar and O'Neill. Staff is requesting
11 the Board of Directors consider approving the proposed rule on
12 acquired member assets and core mission activities, investments,
13 and advances. This rule would broaden the authority of the Banks
14 to engage in new and existing business activities with their
15 member institutions and associates. It would also clarify a
16 requirement of the Banks to address core mission activities in
17 their strategic plans, as described in Part 917.

18 The proposed rule authorizes the Banks to acquire
19 member assets, a new designation of assets that derives from
20 changes contained in the Financial Services Modernization Act and
21 from refinements to existing Finance Board requirements for
22 mortgage purchase programs. Specifically, member assets of a
23 Bank would have to be acquired for members or associates and
24 would have to be whole loans that qualify as collateral for
25 Federal Home Loan Bank advances.

26 Currently, member assets acquired by the Banks are
27 whole mortgage loans, and it is likely that whole mortgage loans

1 will continue to be the primary assets acquired. In keeping with
2 the expansion of the advanced collateral provided in the
3 Modernization Act, the proposed rule includes small business,
4 small farm, and agribusiness whole loans acquired from CFIs, or
5 community financial institutions, as eligible acquired member
6 assets.

7 When the Finance Board adopted resolution 99-50 last
8 October, it granted the Banks more general authorization for the
9 acquisition of single-family member mortgage assets and
10 established specific risk-sharing requirements. Under the
11 proposed rule, these risk-sharing requirements would be further
12 refined to clarify the Banks' and members' responsibilities
13 regarding the acquisition of member assets.

14 And just to clarify, housing finance agency bonds
15 rated at least investment grade, and government-insured or
16 guaranteed loans, that is, FHA, VA, and RHS, would meet
17 the risk-sharing requirement.

18 An important consequence of this rule is that by
19 authorizing the Banks to acquire member mortgage assets. This
20 rule would replace the existing authorities for member mortgage
21 purchase programs, thus moving such programs, and MBS is by far
22 the largest, from pilot to permanent status. The permanent status
23 of the mortgage purchase programs is supported by the success
24 that the Banks have demonstrated with developing and implementing
25 the MPF program in particular. It is also supported by the
26 results of staff analysis of MPF loans, which indicated that to

1 date the demographic characteristics of MPF loans is roughly
2 similar to those acquired by Fannie Mae and Freddie Mac. The
3 analysis is included in your Board book.

4 The proposed rule also defines core mission
5 activities to include primarily acquired member assets,
6 advances, direct investments for certain targeted areas or
7 populations, plus several specific investments, including
8 investments in SBICs, HUD 108 securities, short-term SBA
9 paper, and investments or obligations issued or guaranteed
10 under NAHSDA.

11 However, the definition would contain some
12 limitations, most notably the following, which is intended
13 to encourage the Banks to acquire member assets from a broad
14 array of what is available in the marketplace.
15 Specifically, in any calendar year a Bank or group of Banks
16 would only be able to count acquired government insured or
17 guaranteed loans as core mission up to 33 percent of all
18 acquired member assets. This limitation would not, however,
19 apply to government loans acquired under existing master
20 commitments.

21 Also notable is that MBS would be excluded from
22 the definition of core mission activities consistent with
23 the FMMA proposed rule approved by the Board last summer.
24 The purpose of the core mission definition is to clarify
25 which activities must be addressed in the strategic plan to
26 be developed by each Bank. The definition would not impose
27 any limitations of any kind on the current activities and

1 Banks.

2 Finally, the proposed rule contains an updated
3 investment authority and a new provision for advances, both
4 of which are included to achieve completeness and consistency
5 with the provisions of this proposed rule. The proposed rule also
6 contains a risk-based capital requirement applicable to all
7 investments acquired under the new authority, including acquired
8 member assets, which are rated below the second highest credit
9 rating category, or AA. Of course, under the proposed rule Part
10 980, approved by the Board at the last meeting, a Bank would have
11 to submit a written notice to the Finance Board of any new
12 business activities it intends to undertake. I would be
13 happy to answer any questions.

14 CHAIRMAN MORRISON: The floor is open for questions,
15 comments. I know we have an amendment that is going to be
16 offered by Mr. O'Neill. Mr. Apgar, do you want to speak to any
17 aspect of this at this time?

18 MR. APGAR: No. I think we have been working on
19 this for a long time, and there is a lot of things I like
20 about this. I'm particularly pleased by the emergence of
21 targeted investment. I have been consistent since I have
22 been on the Board of the importance of getting the Banks
23 more involved in certain targeted investments, and I'm
24 especially pleased to see that we are able to get \$200
25 million in authority for the Federal Home Loan Banks to make

1 these equity and debt investments, that will receive favorable
2 capital charge. The Banks need to be good community partners,
3 and this will give them new tools to do that exactly.

4 I also am heartened by the report that has been
5 prepared about the results of the early pilot borrowers, the
6 income profile and other characteristics is a further
7 affirmation of the important role that the Banks can play in
8 providing home ownership opportunities for low and moderate
9 income borrowers. And I think it is an excellent record. I
10 have been looking for reporting requirements so that we
11 could tell the story best. And I think the data suggests
12 that it will be a good story that we tell as these
13 activities unroll.

14 With respect to the involvement of FHA and the
15 caps on government loans that are included in here, I am
16 pleased that the FHA loans have been viewed as such a good
17 product that Banks are clamoring to use them in the early
18 going with the required member assets. FHA has been the
19 marquee in good quality lending for 60 years, and we think
20 that people recognize it.

21 At the same time, I would also note that it is
22 important for these new tools to be used to expand beyond
23 existing channels of access to capital to underserved
24 borrowers. And if you do not do that, we will not fully
25 utilize the benefit of the Federal Home Loan Bank System.
26 That is why I think we have drafted a rule here which will
27 allow a government backs to be included in member assets,

1 provide significant incentives to make sure that the true
2 potential of this operation expanded into the conventional
3 market is realized as well. So I think we have got a good
4 feature in terms of how we are handling that.

5 I have got specific questions.

6 MR. O'NEILL: Go ahead, go ahead.

7 MR. APGAR: Well, just a couple of points. I have
8 been consistently concerned that although much of the
9 discussion is about single-family mortgage assets, that we
10 also are building a base for expansion into the multi-family
11 arena, and maybe discuss a little bit about the role and how
12 it relates to multi-family lending.

13 MR. SMITH: Well, multi-family loans would be
14 treated the same way as single-family loans, as acquired
15 member assets. It would be subject to the same risk-sharing
16 requirement and the same reporting requirements we have.
17 And we are aware that the Banks, several Banks, are pursuing
18 multi-family programs at the moment.

19 MR. O'NEILL: To this date, the pilots have not
20 had any multi-family feature.

21 MR. SMITH: That is correct.

22 CHAIRMAN MORRISON: No, no, that is not correct.
23 The Atlanta pilot, which is run in North Carolina, is a
24 multi-family program. However, that multi-family program
25 has just been a pure participation program without a real
26 structured risk-sharing added. However, the Chicago Bank, the
27 Seattle Bank, and maybe some others, but at least those two,

1 have explicitly indicated an interest and willingness to try
2 to take this concept and make it really work for multi-
3 family. And I completely agree with Mr. Apgar that is not
4 just a thing we should be permitting, but we want to
5 encourage it any way we can.

6 MR. APGAR: So I just ask to review that preamble
7 language to make sure that the sense that these are not just
8 things that are allowable, but encouraged, to be clear, as
9 it states in the preamble.

10 MR. GINSBERG: And just to be clear about what it
11 is we are proposing the Board to do today, the core
12 authorization that is in place now for what we have called today
13 member mortgage assets, is for single-family member mortgage
14 assets. As Chairman Morrison indicates, there are other pilots
15 significantly smaller in scale, that are authorized to do multi-
16 family and that have done multi-family.

17 Today, we would take that core authorization for
18 what we are now calling acquired member assets and extend
19 that beyond single-family to multi-family. And the staff
20 would be happy, obviously, to review the preamble, Mr. Apgar, and
21 make sure that it reflects the desire of the Board to see that
22 that happen.

23 MR. APGAR: Then one last point is on the effective
24 date of the various provisions in the rule, it is my
25 understanding that the various provisions will be effective as of
26 today's date, April 12th. Is that correct?

27 I see here in this section it refers to a specific, I'm

1 talking on page 39. All the provisions are proposed to be
2 effective of April 12, 2000.

3 MR. RAUDENBUSH: That's not the way it is written,
4 however. If you care to clarify that now, we can.

5 CHAIRMAN MORRISON: If the question you are asking is
6 about this, you are referring to the FNP grandfathering that
7 particular
8 language.

9 MR. APGAR: Right.

10 CHAIRMAN MORRISON: There is the additional date
11 issue that has to do with the FHA ratio. With respect to
12 both of those, I think what we were doing is the date of
13 publication of this rule.

14 MR. APGAR: When do we anticipate the date of
15 publication?

16 CHAIRMAN MORRISON: As soon as we can turn this
17 out some time this week, and then the Federal Register. I
18 don't know how long the Federal Register takes. It is just
19 a notice issue of having it the date of publication rather
20 than the date of the meeting, although we could do the date
21 of the meeting if it is of consequence to anybody. I mean,
22 I am happy to have it be April 12th or the date of
23 publication. Either of those is okay.

24 MR. APGAR: Okay. Well, did I understand that we still
25 have work to do on finalizing the preamble, and that leads to
26 some uncertainty of the date. I would rather have us have it at
27 date certain. And the date of the meeting will be fine.

1 CHAIRMAN MORRISON: Okay. Well, I know you don't agree
2 with that part of the rule. But as to the date of April 12th.

3 MR. O'NEILL: Yeah. But, for example, during the
4 comment period, if we are persuaded.

5 CHAIRMAN MORRISON: You could always change the
6 date. Until it is a final rule, you can change the date.

7 MR. APGAR: Right.

8 CHAIRMAN MORRISON: But the purpose of setting an
9 early date is to give notice, you know, that you can rely on the
10 date. You know it won't get any earlier than April 12th, is
11 really what this is. And if somebody persuades the Board to
12 change that date in a prospective way, that's certainly anybody's
13 right to try to do that.

14 MR. APGAR: Right. We understand that the Federal
15 Register is as prompt as they can be, but there is enough
16 variation in that in their processes.

17 CHAIRMAN MORRISON: Yeah. Let's do it the 12th.

18 MR. APGAR: Set a firm date.

19 CHAIRMAN MORRISON: Okay. Other issues, Mr. Apgar?

20 MR. APGAR: No. That's it.

21 CHAIRMAN MORRISON: Okay. Mr. O'Neill.

22 MR. O'NEILL: One issue, the Chairman brought up that
23 there obviously are different pilots. Of the pilots that we have
24 approved to date, which are acquired member assets, and which
25 ones aren't acquired member assets, just so we know? Is this
26 Atlanta pilot a picnic? Is that an acquired member asset?

27 MR. SMITH: It would not meet the risk-sharing

1 requirement.

2 CHAIRMAN MORRISON: I just to be careful about the
3 words that people are using, all approved pilots up to their
4 approved level are by definition grandfathered as acquired
5 mission assets. There is no take-back of any authority to
6 acquire nor to count as acquired mission assets and as core
7 mission activities. What there is a requirement going forward
8 that a certain risk-sharing
9 arrangement be achieved.

10 Obviously, this is a subject that people can comment on
11 during the proposed regulation that you wouldn't comment on
12 whether they think that is appropriate for all of the different
13 kinds of assets. And that question, you know, will be reacted
14 to.

15 But with that qualification, what Mr. Smith said is
16 correct, which is that these earlier pilots that came before we
17 got a better understanding of how to create risk or essentially
18 recourse type transactions, they don't do that because they are
19 pure participation and they place unrated risk on the books of
20 the Bank. And we're, as a general process, going toward a credit
21 policy which says that generally speaking the Banks can't have,
22 other than secured advances, they can't have that risk on their
23 books.

24 MR. O'NEILL: So the Atlanta pilot is not an
25 acquired member asset.

26 MR. RAUDENBUSH: To the limit.

27 MR. SMITH: Beyond its cap.

1 MR. O'NEILL: Okay.

2 MR. GINSBERG: And that is also true for the New York
3 community mortgage asset pilot.

4 MR. O'NEILL: Now in New York, there is both the CMA
5 and then there is the sequential participation.

6 MR. SMITH: Sequential would meet risk-sharing
7 requirements, so that portion of the program would qualify.

8 MR. O'NEILL: Okay. How about Seattle?

9 MR. SMITH: The FHA pilot?

10 MR. O'NEILL: Yeah.

11 MR. SMITH: It meets the definition because FHA meets
12 it. It meets the risk-sharing.

13 CHAIRMAN MORRISON: Not necessarily. There is no
14 member recourse. I'm not sure it does. You are making an
15 assumption about FHA that we found not to be true.

16 MR. SMITH: I'm sorry.

17 CHAIRMAN MORRISON: Which is that there is a recourse
18 issue.

19 MR. O'NEILL: I just figured it would be nice to talk
20 about pilots that we already have. So thank you.

21 CHAIRMAN MORRISON: If you want to offer your amendment
22 now or any other questions or comments, please, go ahead and
23 offer your amendment.

24 MR. O'NEILL: Okay. Here are copies. The amendment
25 would delete the entire 940 dealing with core mission activities,
26 which I guess is on pages 1 to 4. And there are two references
27 to Part 940 investments, one on page 12, Section 956.3(a)(1), and

1 a second one page 13, 956.3(a)(3)(1). And I guess there are two
2 points that I would like to bring up.

3 First is the point that I have made before that is that
4 to me, Congress makes the laws, and that the regulators interpret
5 and implement the laws. And I think when it comes to mission, we
6 have more than enough direction from Congress about what is and
7 what isn't mission-related. So the first point is that, as I
8 have said before, that it should be the Congress rather than the
9 Finance Board that should do it. But the second issue, I guess,
10 is more as far as the timing of this thing. And that is that
11 even assuming that the Finance Board should say something about
12 core mission activities, I think that this is not the time
13 to say it, for a couple of reasons.

14 And basically, it all boils down to we are in a
15 transition period where we are trying to implement Graham-Leach-
16 Bliley. For example, right now, for the first time, the entire
17 System has one level of capital, which was not the case before
18 October 12th. We don't know how that will play out because,
19 obviously, that is an ongoing modification.

20 Secondly, and probably more importantly, we are right
21 in the middle of a risk-based capital reg. And we don't know
22 what we're going to propose yet, and then there is a 90-day
23 comment period. And then we will modify it. So we don't know
24 what the risk-based capital provision will look like. And I
25 think that again is something that we ought to do, not only
26 because Graham-Leach-Bliley says that we should do it, but I
27 think also, Mr. Chairman, to your credit, this is one of the

1 things that you were most insistent on that Graham-Leach-Bliley
2 do, that it does contain capital. If it wasn't for you, that
3 would never happen.

4 So now that that has happened, why don't we see both
5 what the regulation that we put out; and secondly, what the 12
6 Banks with their capital plans do in response to our regulation.
7 And I guess the other thing is I view this basically as a two-
8 year process, both our coming out with what we are going to come
9 out with, and then the 12 Banks coming up with their capital
10 plans. And, obviously, we don't know what anything will look
11 like in two years, including in that the Federal Home Loan Bank
12 System.

13 So it is possible that because of risk based capital
14 that when we are finished with that, the 12 Banks will be very
15 mission-related, and there will be a lot less nonmission-related
16 assets. And if that is the case, why are we now seeing something
17 about a problem that might not even be there?

18 As I said before, we should and we are working on both
19 collateral things that we have to focus on because that is what
20 Graham-Leach-Bliley is about. And I think that should be the
21 focus of our efforts.

22 CHAIRMAN MORRISON: If I could just ask you one
23 question. You said that in two years the Banks might be more
24 mission-related, largely mission-related, and therefore we
25 wouldn't have to solve any problem. If we didn't define what it
26 meant to be more mission-related, how would we know whether they
27 were more mission-related or not? How can you make a judgment

1 about how mission-related something is if you don't tell yourself
2 as well as the rest of the world what is defined as more mission-
3 related?

4 MR. O'NEILL: Well, obviously, this Board has put in a
5 new term called "acquired member assets". The fact that we put
6 this new term in there, I think all of the Banks know that we are
7 in favor of acquired member assets. So by just putting something
8 like that out, proposing it, I think that is all the signal that
9 we should need to have, that that is the way that we want the
10 System to go.

11 CHAIRMAN MORRISON: But in the same regulation where we
12 have done that, we have included a wide range of investments that
13 are much less focused on the member mortgage business. I mean,
14 obviously, mortgage backed securities are specifically authorized
15 in the proposed rule, as well as various kinds of corporate
16 securities that have certain investment grade. So I agree we
17 know, that's why we are writing in the section, in other words,
18 so everybody else knows. I mean, you know, we have discussed
19 this till we are blue in the face.

20 So we know what we mean. But I'm at a loss to
21 understand why we would want to put our stamp of definition on
22 the very thing that you are saying, which is yes, we think
23 acquired member assets are core mission activities, so let's say
24 so. That is what the rule proposes to do.

25 MR. O'NEILL: Well, I guess you were anticipating
26 a compliment that I was going to give to the staff, which is
27 that the investment section is a very faithful retelling of

1 what Congress says are investments that the Federal Home
2 Loan Banks can invest in. So again, I think that Congress
3 should make those calls, not us. And so Congress says that
4 those things are okay for the Federal Home Loan Banks to do,
5 so that's Congress' view, and Congress should rule in that
6 regard.

7 One specific thing about the FHA, I guess we are
8 sending a contradictory signal, on the one hand saying that
9 we are lifting the \$9 billion cap and saying that programs
10 like the Chicago pilot and the three district mortgage
11 purchase program, that those are not any longer pilots, they
12 are normal programs, and we have no caps. But at the same
13 time, we are setting a subcap for FHA. And to me, you
14 either are lifting things, or you are putting in more
15 restrictions. But in this regard, I think we are trying to
16 do both.

17 Just two more things, one thing is that all of the
18 trade associations, I think, are against this, again I think
19 because they think it goes against Congressional intent. And the
20 last thing, Mr. Chairman, is several times you have said to me
21 that the examiners need more guidance about what exactly is
22 mission-related and what isn't mission-related. Well, I think
23 then the different regs that we have already had, that they have
24 all of the guidance that is needed.

25 We have it here on investments. We have a regulation
26 on advances that sets out what is and what isn't allowed. We
27 have on letters of credit. We have all kinds of different

1 regulations out there now that say these are the things that we
2 want the Federal Home Loan Banks to do, and this is the way that
3 we want it to be done.

4 So I don't think that a mission reg adds anything at
5 all. So my amendment is to strike core mission activity from
6 this reg. Thank you.

7 CHAIRMAN MORRISON: Mr. Apgar?

8 MR. APGAR: Well, just a couple of comments. I mean, I
9 think we are in a period of transition, and I think why it is
10 absolutely essentially that we provide clarity on what we mean by
11 core mission assets and types of activities that this rule does.
12 I understand that there are a lot of interlocking pieces of it
13 coming together, but it seems like this part is useful to
14 establish as we go forward. So at the rate the financial
15 communities are going, looking for a point of stability when you
16 can do this from strength, it will never happen.

17 So I just don't understand why this is not the time to
18 make a statement that we want to talk about here.

19 CHAIRMAN MORRISON: Just several things I would like to
20 say that really go to the rule as a whole as well as to the
21 proposed amendment. Obviously, this is a proposed rule, and we
22 will get comments on all of these conflicting or competing ideas.
23 But this rule really captures for me the job of the regulator and
24 the Congress working together with respect to the mission of the
25 GSE.

26 Congress writes a charter, and the charter really
27 defines the outer boundaries of legally permissible activities of

1 a government sponsored enterprise, and that is, you know, the
2 calling balls and strikes or foul or fair that is there. And the
3 portion of this rule that has to do with authorities really is
4 that giving regulatory interpretation to the charter that
5 Congress has written about these things. And quite frankly, the
6 notion that the Congressional language solves all problems is
7 certainly belied by the litigation over the mortgage partnership
8 finance program that obviously there were people with highly
9 skilled lawyers who thought that wasn't within the gambit of what
10 Congress said. We thought it was, and the court said we were
11 right.

12 But the point is, it was an arguable point that
13 reasonable people differed on. So Congress just doesn't
14 legislate, you know, in a way that answers every question that
15 arises. And it is our job to provide that added definition.

16 But within the charter that government sponsored
17 enterprises are given of all of their permissible activities,
18 there is the charge to their mission regulator, in our case, it
19 says insure that their housing finance mission is carried out.
20 There is the obligation to talk about maximizing the benefit, the
21 public benefit, from the GSE status. And that is a circle that
22 is within what is allowed, a smaller circle. And that's what you
23 can argue endlessly about whether something that is within the
24 charter is therefore mission. And that is why we have used the
25 word core because whether it is mission or not isn't really what
26 is important.

1 What is important is what is really important, what
2 really provides benefit. And our job is not only to call balls
3 and strikes at the border, but also to encourage the things in
4 the center that do the most for the marketplace, that do the most
5 for the public so that the Congress, in allowing special benefits
6 to GSEs, can be confident that the public is getting those
7 benefits rather than someone else.

8 So that is really what the point of the two circles is,
9 and that is really our job. And if we don't say what we think
10 about that, we're really not doing then half of our job. And
11 that is really why this needs to be here. And an example that I
12 think would carry through, Congress just changed the collateral
13 and the membership rules, and would we think it was okay if the
14 regulated entities just didn't do any of that, whether they just
15 didn't accept the new collateral at all, and they just left those
16 thousand new potential members out there without being able to
17 get into the System, without being able to borrow from the
18 System? No, we wouldn't think that that was okay, even though
19 this is just a legal authority.

20 So this core mission activity specifically defining the
21 breadth of the authority and what needs to be done for mission is
22 an important part of our job. At least that is the way I look at
23 this.

24 Just a couple of other things that respond really to
25 things you have said and things that have been said to us. One
26 is that this question of whether we should do capital first.
27 What this proposed rule says in its definition of core mission

1 activity is these are the things that this board believes are
2 most important for this entity, this Federal Home Loan Bank
3 System to accomplish. And in saying that, we are not setting
4 limits on it.

5 We are saying to the Boards of the Banks, include this
6 in your planning to try to maximize this public benefit. And I
7 hope that there will never need to be any limits like we proposed
8 in FMMA because the process at the board of directors' levels of
9 the individual Banks and the marketplace will move the System to
10 do things that are more rather than less helpful to the members
11 and more and less helpful to their customers. And if that
12 happens, I'll be the happiest person there is, because the limits
13 are just a tool. They are not really the essence of what we are
14 trying to accomplish.

15 But if we don't tell people before they write their
16 capital plans, the kinds of assets they are likely to have to
17 capitalize, will it be easier afterwards to say to them
18 afterwards, oh, by the way, here is what we really care about,
19 and say, well, we really didn't write our capital plans that way.
20 We assumed that we do something else.

21 I know that people think that it is hard to do all
22 of these things at once. One way or another, we have to do
23 them all at once. So by giving notice up front, it seems to
24 me we can change it if in the capital planning process we
25 learn something about the ability to capitalize these assets.
26 But at least we ought to give people fair warning about what our

1 thinking is on the normative judgment about what really makes the
2 most difference.

3 And, you know, I think that what is happening out there
4 is very encouraging to the idea that this debate will be mostly
5 seen in a few years as purely theoretically, and that this is the
6 way the System goes. And that will be great if that happens.
7 Then we can just write in our memoirs about our pyrrhic victories
8 and defeats. But we'll see.

9 There is a concern that has been expressed by some
10 about the amount of time to consider this. There will be plenty
11 of time, and we're very open to, you know, a process of involving
12 the members and their representatives in the trade association as
13 we develop this capital plan, which really is going to be at the
14 heart of the economics of the System going forward. And I think
15 that's where we go.

16 I want to say one other thing about what you said about
17 sublimits or about the definitional issues about government
18 sponsored insured instruments. What we are saying in this
19 proposed rule is that we don't want to see a market division
20 where the Federal Home Loan Banks focus their attention on
21 acquired products solely on government insured, and leaving the
22 conventional marketplace as well as the subprime marketplace
23 solely to existing secondary market GSEs, but rather the whole
24 idea here is to competition across the board, and that what we
25 are saying here is not don't do this, but do the other. And the
26 one-third ratio is based on marketplace numbers that are a fair

1 indication of what would show that both marketplaces were being
2 pursued.

3 It's an incentive based System. There is not going to
4 be any problem if people do what they say they are going to do
5 because people have said it is just a matter of what comes first
6 and which things come sooner, which come easier. And this will
7 all, you know, come out in the wash over the next year or two,
8 assuming that both marketplaces are pursued because the volumes
9 are sufficiently that that will be how it comes out.

10 So, you know, we use the tools that we have available
11 to us, and I think that is what we are doing here.

12 MR. O'NEILL: Can I respond.

13 CHAIRMAN MORRISON: Certainly.

14 MR. O'NEILL: One thing, to respond. This is a
15 public/private System. And I think that people that should make
16 the decisions are not the Finance Board, not the presidents of
17 the Federal Home Loan Banks, not anybody but what the marketplace
18 thinks is added value for the System. And so what you are doing
19 when you are saying, oh, only a third of FHA is going to be
20 counted.

21 CHAIRMAN MORRISON: No, that's not what it says. It
22 says that FHA will be counted up to a third of all acquired
23 member assets.

24 MR. O'NEILL: Well, basically, I think that we are
25 saying that we know better than the markets about what is the
26 best way for this System to develop. And I think that any limits
27 that we put, the markets don't like. And so you might think that

1 you are just putting that limit. But it might be, as a matter of
2 fact, I saw a letter from one Bank president who says that if you
3 kill off the FHA portion by limiting it, you will in fact kill
4 the entire Chicago pilot.

5 Although we have to ensure that this System is both
6 safe and sound and has a mission component, if you go too far
7 into the details, you might have unforeseen consequences because
8 the markets don't view things the way that we might. So that's
9 why I think it is best to leave it to the markets.

10 MR. APGAR: Well, I mean, my sense is we are not
11 killing the Chicago pilot. We are encouraging it to reach its
12 full potential, and that the full potential of the Chicago pilot
13 is to be a broad range of access to mortgage, especially ones
14 that aren't well made in the current marketplace.

15 Clearly, there has been some ease of moving more
16 quickly the government guaranteed portion, if only because there
17 is perception among the members of less risk, even maybe less
18 understanding of the amount of risk they are bearing in taking on
19 this role, that there is a sense that this is easily done.

20 The detail of creating the opportunities for
21 conventional financing through these Systems and making the
22 executions work for smaller Banks with the conventional portion
23 that really is the growth potential is work that has to be done.

24 There is no thing as a free market. There is market
25 that takes place in the context of institutions that have to have
26 rules, regulations, and practices that make that happen. And
27 once the effort is intended to making the executions in the

1 conventional side as seamless as they are in the FHA side, this
2 will disappear as an issue because the real potential is on the
3 conventional side.

4 But to not give some incentive for that to happen risks
5 that it doesn't happen. And I think that's something I was not
6 willing to do, to give it a chance to realize its full potential
7 of what we are doing here.

8 CHAIRMAN MORRISON: Well, I just hope that people don't
9 believe here over-the-top rhetoric that has been expressed on
10 this point by some of the people in the Federal Home Loan Bank
11 System. The fact is that when MPF was proposed and approved and
12 all of the rest, there was absolutely no suggestion whatsoever
13 that any FHA or VA product would ever be brought under it. And
14 the whole concept was sold on the grounds of the conventional
15 market. And so the notion that telling people to do what they
16 said they were going to do all along as somehow, you know, a bolt
17 out of the blue that we thought of is ridiculous. I mean, the
18 fact is that I am glad that the FHA marketplace is also going to
19 benefit, and no one is saying that it is not. But it really just
20 won't do to have this doom and gloom by saying, you know, don't
21 just compete with Ginnie Mae, but compete with Fannie and
22 Freddie, too. And we all know it is talking about the free
23 market in an environment where we have Fannie, Freddie, and
24 Ginnie, as well as the Federal Home Loan Banks, which is all
25 government assisted, not to speak of the home mortgage deduction.

26 I mean, please, I mean, this is a government regulated
27 marketplace. And who wins and who loses is all determined by

1 capital rules made by government and by borrowing rates and all
2 of the rest. So, you know, this market hasn't been free for 70
3 years, thank God, because it has really given benefits to the
4 American people. But we all who are in the public sector have to
5 do something about that.

6 So I don't think that this program is at any risk
7 because every one of the members of this Board has forthrightly
8 supported this initiative, even though there are a lot of people
9 in the political process who have wanted to kill it off because
10 just of whom it was competing with. And so, you know, the leaders
11 in the Bank System need to, you know, get about the business of
12 making it work. And they can make it work in the conventional
13 market. And the most important thing they can do is get over
14 there at the FFIEC agencies and help them rewrite these capital
15 rules so that recourse transactions get fair capital, which is
16 what this is all about. And there is work to be done that
17 doesn't have anything to do with us.

18 We have been bending over backwards to make this work.
19 It needs the primary regulators of banking institutions to get
20 the rules right, and they have proposed to do so. So, you know,
21 I think that is great, and I think we should support them, and I
22 think the Bank should get over there and support them. And then
23 the conventional market will go as easily as the FHA market. So
24 that is all we are going to have.

25 Any further debate after that blast, who wants to get
26 the fire hose next?

27 MR. APGAR: Does anyone have any opinions on this?

1 CHAIRMAN MORRISON: All in favor of the amendment,
2 please say aye.

3 DIRECTOR O'NEILL: Yes.

4 CHAIRMAN MORRISON: Opposed no.

5 CHAIRMAN MORRISON and DIRECTOR APGAR: No.

6 CHAIRMAN MORRISON: No. The amendment is not
7 agreed to. Any further debate, comments or questions before
8 we vote on the rule? Mr. Ginsberg?

9 MR. GINSBERG: Mr. Chairman and members of the Board,
10 just one matter I would like to address that has come to the
11 attention of the Board in the last 24 hours. A memorandum to
12 each of you from the Chicago Federal Home Loan Bank, which, of
13 course, is the originator and operator of the programs that we're
14 proposing today to make permanent in the System. The Chicago
15 Bank has raised concerns about the language that is in the
16 proposed rule before you as it relates to the methodology for
17 calculating the credit enhancement, and as to the description of
18 the risk-sharing arrangements that are in the proposed rule.

19 I just wanted to from the staff perspective provide two
20 assurances to the Board; one, that as we review these concerns,
21 to the extent that we believe that Chicago raises legitimate
22 points and that the language can be approved, I'll sure you will
23 treat this as an active comment in the comment process and will
24 address these issues. And we will report to you on that one when
25 the final rule comes back to the Board with any recommended
26 changes, as we would in the normal course.

1 Secondly, I just wanted to say that we as a staff know
2 of no reason why the language that we are proposing,
3 notwithstanding the representations from the Chicago Bank, we
4 know of no reason why the language we are proposing that you
5 adopt today in any way poses a problem to the ongoing operation
6 of MPF in proposed rule form, and notwithstanding some of the
7 rhetoric in this memorandum. And so from the staff's
8 perspective, notwithstanding the issues Chicago has raised, we
9 would urge the Board to go forward.

10 CHAIRMAN MORRISON: Anything further on any comments
11 from my colleagues? If not, the vote occurs on the adoption of
12 the rule. All in favor of adopting the rule, please say aye.

13 CHAIRMAN MORRISON and DIRECTOR APGAR: Yes

14 CHAIRMAN MORRISON: Opposed, no.

15 DIRECTOR O'NEILL: No.

16 CHAIRMAN MORRISON: The ayes have it, and the rule is
17 adopted. I ask unanimous consent that the staff have permission
18 to make technical and conforming changes, including to the
19 preamble. But in light of the draft status of the preamble, that
20 it be circulated fully to the Board members for any editorial
21 changes that need to occur before publication. Without
22 objection, so ordered, and the meeting is adjourned.

23 (Whereupon, at 11:03 a.m., the meeting was adjourned.)

24

1 REPORTER'S CERTIFICATE

2 DOCKET NO.: N/A
3 CASE TITLE: FEDERAL HOUSING FINANCE BOARD / OPEN MEETING
4 HEARING DATE: April 12, 2000
5 LOCATION: Washington, DC

6

7 I hereby certify that the proceedings and evidence are
8 contained fully and accurately on the tapes and notes reported by
9 me at the hearing in the above case before the Federal Housing
10 Finance Board.

11

12

13 Date: April 12, 2000

14

15 Jan M. Jablonsky

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