

FEDERAL HOUSING FINANCE BOARD

IN THE MATTER OF:)
)
OPEN MEETING)
)

Second Floor
Federal Housing Finance Board
1777 F Street, N.W.
Washington, D.C. 20006

Friday,
June 23, 2000

The parties met, pursuant to the notice, at
10:19 a.m.

BEFORE: BRUCE A. MORRISON, Chairman

APPEARANCES:

Board Members:

WILLIAM C. APGAR
J. TIMOTHY O'NEILL

Staff:

WILLIAM W. GINSBERG
DEBORAH F. SILBERMAN
SHARON LIKE
JENNIFER SALAMON
LORI COWARD

P R O C E E D I N G S

(10:19 a.m.)

MR. MORRISON: The meeting will come to order.

And let me open the meeting by moving that the Board of Directors determine that Finance Board business requires calling today's open meeting on less than seven days notice to the public, and that no earlier notice of this meeting was practical. This meeting will include the following items: final rule, amendments to membership regulation and advances regulation; final rule, election of Federal Home Loan Bank directors; and third, resolution required by Section 608 of the Federal Home Loan Bank Modernization Act certifying that withdrawal of Bank System members will not cause the Bank System to fail to its REFCorp obligations.

Without objection, the motion is agreed to. And we move to item one on the agenda, the final rule, membership regulation and advances regulation, Mr. Managing Director.

MR. GINSBERG: I'm going to turn this over to the Office of General Counsel, Sharon Like.

MS. LIKE: Thank you. Staff is presenting for your consideration a final rule that finalizes with several changes the interim final rule which amended the membership eligibility stock purchase and nonqualified thrift lender advances provisions in the Finance Board's regulations.

1 This was done in order to conform them to the requirements
2 of the Federal Home Loan Bank System Modernization Act of
3 1999.

4 The interim final rule was published in the
5 Federal Register and became effective on March 15, 2000, and
6 provided for a 30 day public comment period, which closed on
7 April 14th. The Finance Board received seven comment
8 letters from four Federal Home Loan Banks and three
9 financial institution trade association. Commenters
10 generally were supportive of the interim final rule. Staff
11 has considered the comments and is recommending that the
12 Board adopt the final rule set forth in your Board packages.

13 The final rule provisions generally are consistent with
14 those of the interim final rule, with one change related to
15 the definition of community financial institution.

16 Pursuant to the Modernization Act amendments, the
17 interim final rule amended the membership regulation to
18 exempt community financial institutions, or CFIs, from the
19 statutory requirement that applicants for membership have at
20 least 10 percent of their total assets in residential
21 mortgage loans. The interim final rule amendments are
22 adopted without change in the final rule.

23 The interim final rule also added a definition of
24 community financial institution that mirrored the
25 Modernization Act definition of the term, which is an FDIC

1 insured institution that has less than 500 million in
2 average total assets based on an average total assets over
3 the three years proceeding the date of the transaction.

4 In the interim final rule, the Finance Board
5 requested comment on what source of data should be used in
6 calculating the average of total assets over the three
7 proceeding years. The issue of how to calculate that
8 average also arises in the context of the new authority
9 under the Modernization Act allowing CFI members to pledge
10 secured small business or agricultural loans as security for
11 advances. The Finance Board recently issued a proposed rule
12 to implement that new authority.

13 The comments received on the interim final rule
14 addressed the administrative burden and cost of performing
15 more frequent periodic calculations of the average,
16 coordinating the calculation with the annual stock purchase
17 calculation and the effect of periodic calculations on the
18 use of Bank funding.

19 However, for membership purposes, the
20 determination of whether an institution applying for a
21 membership is CFI and therefore exempt from the 10 percent
22 requirement is only required to be made by the Bank one time
23 during the membership evaluation process. Thus the comments
24 really are not relevant to the membership application
25 process and appear instead to be directed at how CFI's

1 status should be calculated for purposes of allowing CFI
2 members to use the expanded collateral authority. So the
3 comments and the definition of CFI for advances collateral
4 purposes will be addressed in the Finance Board's final
5 advances collateral rule.

6 Under the current membership regulation, the
7 calculation of the 10 percent test is based on the
8 applicant's total assets and residential mortgage loans
9 drawn from its most recent quarterly regulatory financial
10 report. Since the calculation of average total assets to
11 determine CFI status is necessary in order to determine
12 whether the 10 percent requirement applies, it would be
13 consistent with the current membership review process at the
14 Banks to use the same total assets data from the most recent
15 quarterly call report for the CFI calculation.

16 In addition, since an average is required over
17 three years, it would be reasonable to include in the
18 calculation the total assets data from the quarterly
19 financial reports for the immediately preceding 11 calendar
20 quarters. So we're proposing that the definition of CFI
21 include that kind of a calculation for membership purposes.

22 Because the definition applies to both advances collateral
23 purposes and membership purposes, we would propose that that
24 definition be put in Part 900 of the Finance Board's
25 regulations, which contains the general definitions that

1 apply to all regulations. That will be handled in the final
2 advances collateral rule, and therefore we are simply
3 removing the CFI definition from the membership regulation.

4 That would be achieved in this final rule.

5 Also pursuant to the Modernization Act amendments,
6 the interim final rule removed from the membership
7 regulation the automatic membership provisions for federal
8 savings associations, which now must apply for Bank
9 membership like all other voluntary members. These interim
10 final rule amendments are adopted without change in the
11 final rule.

12 Also pursuant to the Modernization Act amendments,
13 the interim final rule amended the membership regulation to
14 reduce in from ten to five years the period of time that
15 former members must wait before they are eligible to reapply
16 for admission in the system. The finally adopts those
17 changes essentially without change except for some minor
18 technical clarifying language.

19 Also pursuant to the Modernization Act amendments,
20 the interim final rule removed provisions from the
21 membership and advances regulations containing the
22 additional capital stock purchase requirements and
23 limitations on advances applicable to nonqualified thrift
24 lender members. These amendments are adopted without change
25 in the final rule.

1 Finally, unrelated to the Modernization Act
2 amendments, the Finance Board also took the opportunity in
3 the interim final rule to clarify that a newly chartered
4 insured depository institution that is approved for
5 membership and that fails to satisfy the 10 percent test
6 within the required one year statutory period is deemed not
7 to have met statutory criteria for membership, and its
8 conditional membership is deemed null and void by operation
9 of law. This amendment is also adopted without change in
10 the final rule.

11 Any questions, I'll be happy to answer them.

12 MR. MORRISON: On that last point, I take it that
13 that would mean that for the five year bar that such a
14 member which was a de novo and that tried to get in and
15 failed would not be in a five year bar position because it
16 had never been a member.

17 MS. LIKE: That's correct.

18 MR. O'NEILL: Since there is not a five year bar,
19 could they the next year try again?

20 MR. MORRISON: Try again?

21 MS. LIKE: Yes.

22 MR. MORRISON: But otherwise, you are basically
23 saying it is void if you said they were members for that
24 year. Then they would be out for five more years.

25 MS. LIKE: That's right.

1 MR. O'NEILL: So a de novo could apply every year
2 until they made it.

3 MR. MORRISON: They made it.

4 MR. MORRISON: But, I mean, they wouldn't really
5 apply until they had the 10 percent. The Rule allows a de
6 novo to apply before they have accumulated 10 percent so
7 they can use the funding of the Federal Home Loan Bank to
8 try to put assets on their books before they generate as
9 much deposits as they need, et cetera. It is a beneficial
10 provision for de novos.

11 MS. LIKE: That's right.

12 MR. MORRISON: I just wanted to make sure we
13 weren't punishing them, and it is clear that we wouldn't if
14 they fell off. Is there any other question or comments on
15 this?

16 MR. O'NEILL: Well, more comments. First, the
17 staff did excellent work, and I asked and got a memo that
18 Lori Coward did to Jim Bothwell about the effect of Gramm-
19 Leach-Bliley. And I just wanted to note a few numbers.
20 Right now we have as of last September, we have 6,920
21 members of the System. But of those, 6,920, 6,200 would
22 qualify as CFI members. So of the membership that is
23 already there, a big preponderance will meet this test. And
24 right now, the number of members of the System, this is
25 before Gramm-Leach-Bliley, that still have not joined the

1 system is about 2,200. So 2,200 members before Gramm-Leach-
2 Bliley can still join the System. But the newly eligible
3 members, by doing away with the 10 percent test, that is
4 another thousand members of the System that can join now
5 because they don't have to meet the 10 percent test.

6 So we probably over the next several years will
7 continue to increase in membership. And, obviously, we
8 probably will never have the total number of FDIC insured
9 institutions is a little more than 10,000, and we probably
10 will never hit that. But probably over the next, say, five
11 years, we probably will go up to saying 9,000 members. So
12 even though we have had extraordinary growth over the last,
13 say, five years, that probably will continue for the next
14 four or five years. So I just figured that to get a little
15 bit of perspective would be a good thing.

16 MR. MORRISON: Thank you. And any other questions
17 or comments on this rule? If not, the vote occurs on a
18 motion. Could I have a motion to adopt the rule as final?

19 MR. APGAR: So moved.

20 MR. MORRISON: All in favor of adoption of the
21 final rule, please say "aye."

22 (Chorus of ayes)

23 MR. MORRISON: Opposed, no. The ayes have it.
24 The rule is agreed to. And I ask unanimous consent that the
25 staff be permitted to make technical and conforming changes

1 pursuant to the publication process. Without objection, so
2 ordered.

3 Item No. 2, Final Rule, Election of Federal Home
4 Loan Bank directors. Deborah Silberman, this process of
5 these rules and these matrices required by the extra layer
6 of complexity of staggering has driven Neil out of town.

7 MR. MORRISON: And Deb is left to have to suffer
8 the same headache.

9 MS. SILBERMAN: It is with more regret than you
10 can possibly imagine that I have to say that the principal
11 drafter of this regulation is not here. So you're stuck
12 with me. The Finance Board approved a proposed rule
13 relating to the amendments made by the Gramm-Leach-Bliley
14 Act to the directorship provisions of Section 7 of the Bank
15 Act, which was published in the Federal Register on April
16 3rd to come to a 30 day comment period that closed on May
17 3rd.

18 The proposed rule addressed the effect of the
19 Gramm-Leach-Bliley Act on the 1999 election of directors of
20 the Banks and proposed a method for staggering the Board in
21 each Bank into three approximately equal classes as required
22 by the statute. And the staff is requesting that the
23 Finance Board approve the final rule that is contained in
24 your Board books which is largely the same as the proposed
25 rule.

1 We received a total of 9 comments, most of which
2 were in favor of the rule. The rule makes a number of
3 clarifying changes to the proposed rule regarding the loss
4 of eligibility of a nominee that would occur at different
5 stages of the election process; the effect on any director
6 who is assigned a reduced term as a result of the staggering
7 provisions of Gramm-Leach-Bliley under the term limit
8 provisions of the Bank Act, which was requested by one of
9 the commenters; the inclusion of a safe harbor provision for
10 directors who vote on directorship matters in which the
11 directors have a personal interest, which was requested by
12 one of the commenters; and the assignment of nonguaranteed
13 directorships.

14 The proposal that is in your Board book addresses
15 a situation that arises at one of the Banks, at which a
16 nonguaranteed directorship will change at the end of the
17 year as a result of the 2000 designation of directors that
18 was made by this Board in May. It provides that rather than
19 looking back to a 1998 election to rank the directors, it
20 would require that the board of directors of the Bank
21 determine by lot which director of that Bank is to become
22 ineligible as a result of the redesignation or would allow
23 those directors to resolve the matter among themselves.

24 This would be a one time occurrence because after
25 this year, all nonguaranteed directorships would be

1 determined through the election process on an ongoing basis,
2 and the Bank will know which directors will occupy
3 nonguaranteed seats because on an ongoing basis, the
4 matrices of the process will work, we hope.

5 The next of the changes is a conforming amendment
6 to the Gramm-Leach-Bliley Act, it makes a change from the
7 proposed rule that says that directors can either be bona
8 fide residents of the district or officers or directors of a
9 member. We had inadvertently made the officer or director
10 of a member requirement a subset of bona fide resident in
11 the proposed rule, where the Gramm-Leach-Bliley Act makes
12 those two alternatives. And so we have corrected that in
13 the final rule.

14 The final rule also addresses a problem that
15 otherwise would be caused when directors from the state are
16 elected without any vote, which would occur when the number
17 of nominees is equal to or less than the number of seats
18 from a state to be filled in an election by providing that a
19 Bank may declare nominees elected without an election only
20 if the number of nominees is equal to or less than the
21 number of directorships to be filled, and all the
22 directorships have the same term, and guaranteed and
23 nonguaranteed status. So everything has to be the same so
24 that that is the only way you can declare all of the
25 nominees elected without a vote.

1 This final rule makes it clear that in all
2 elections after 2001, nonguaranteed directorships will be
3 assigned on the basis of votes received. The proposed rule
4 was not entirely clear on how this was to be addressed in
5 post-2001 elections, so we have clarified that. The final
6 rule requires the Banks to inform the Finance Board how they
7 have allocated short terms among the states, which is a
8 requirement that the Banks have to do, which the Finance
9 Board needs in order to prepare the matrices for the Banks
10 next year.

11 It also addresses situations that have occurred in
12 one of the Banks in which three persons who were elected in
13 '99 without a vote because the number of nominees equaled
14 the number of directorships to be filled. One of the
15 directors must be assigned a two-year term, but there is no
16 vote on which to rank those directors. And again, the final
17 that is in your Board book provides that the Bank must make
18 that decision by lot or would allow the directors to agree
19 which of those directors receives the short term.

20 Because of the complexity again of the layering of
21 the staggering and the term requirements that were made by
22 Gramm-Leach-Bliley on top of all of the state requirements
23 of Section 7 is an incredibly layered and structured scheme
24 that through this process we have made as straightforward as
25 it can be made, given the scheme. And I'll be happy to try

1 and answer questions, but don't count on it.

2 MR. MORRISON: Well, I think the fair thing to be
3 said is that the rules, the quotas, and the annual
4 determination of allocation of seats was difficult when it
5 was two years, but impossible when it is three because at
6 two years, you never were more than a year off, so you could
7 tolerate certain inequalities that would work out the next
8 year. But it gets to be three years, and everything has to
9 be staggered. You go over a certain line of complexity.

10 But I think by creating these matrices, if you are
11 not one of the 12 people in America who actually understand
12 this because you have to every year, it seems terribly
13 complex. But actually, all you have to do is look at the
14 matrix, and the answer falls right out. So it is
15 complicated, but in fact not confusing, for those people who
16 have to do it. And everybody else doesn't need to know. I
17 mean, it is one of those things. It is like the tax code.

18 The answer is very simple if you know how to read
19 it. But if you don't, forget it, you'll never figure it
20 out. So that is kind of what we have got here.

21 The good news is that the Banks, as we set forth
22 with a good deal of support and precision in our proposed
23 rule on capital, the Banks are free to fly away from all of
24 this complexity as part of the capital plans, and they can
25 come up with a much more straightforward and forward looking

1 rather than backward looking set of allocations if they
2 wish. And they also can try to replicate this if they can,
3 too. But we have made that maybe clear that we are free by
4 the essence of Section 6 in the Gramm-Leach-Bliley Act to
5 allow them under the capital plan to simplify and modernize
6 if they choose.

7 Are there any questions or comments about this
8 rule? You have an amendment, Mr. O'Neill. Let me move that
9 the rule be adopted so that you may move to amend the rule.

10 MR. O'NEILL: I'm sorry to have an amendment
11 because it only kind of further confuses things. But let's
12 see if I can do this simply. For elections before 1999,
13 there was, and this is Neil Crowley's words "There was an
14 inference that we would look at past elections, but it
15 really wasn't set out anywhere". So what was in the Board
16 book is this, as Deb said, this process of drawing lots.

17 What my amendment would say is in the two cases
18 where we have to look back earlier than 1999, we look back
19 to previous elections and whoever gets the most votes would
20 be the person that would have the preference; the person
21 with the least votes, the one that wouldn't have a
22 preference. And the good news is before Neil Crowley left,
23 he did my amendment in a very clever way, which is these
24 four pages, two pages of the preamble and two pages of the
25 regulation, can simply be slipped in to what is in the Board

1 book.

2 So that is my amendment. And if you want to ask
3 me any questions about it, I'll see if I can answer those
4 questions.

5 MR. MORRISON: So the amendment is that pages 12,
6 22, 36, and 41 be substituted by these four pages that you
7 have distributed.

8 MR. APGAR: Well, as you know, we talked about it
9 in a little side conversation before so that I would not
10 appear stupid in response to the issue and appealing back to
11 a vote.

12 MR. MORRISON: Okay. All in favor of the
13 amendment, please say "aye."

14 (Chorus of ayes)

15 MR. MORRISON: Opposed, no. The ayes have it.
16 The amendment is agreed to. The vote occurs on the motion
17 to adopt the rule as final. All in favor, please say "aye."

18 (Chorus of ayes)

19 MR. MORRISON: Opposed, no. The rule is adopted.
20 I ask unanimous consent that the staff have permission to
21 make technical and conforming changes as required in the
22 publication process. Without objection, so ordered.

23 Item three. Ms. Silberman, are you still up?

24 MS. SILBERMAN: Yes, sir.

25 MR. MORRISON: Another interesting one.

1 MS. SILBERMAN: But so much easier.

2 MR. MORRISON: This the notice side.

3 MS. SILBERMAN: Yes. The Gramm-Leach-Bliley Act
4 amended the Bank Act to provide that any member may withdraw
5 from a Bank by providing written notice to the Bank of its
6 intent to do so, provided that on the date of withdrawal
7 there is in effect a certification by the Finance Board that
8 the withdrawal will not cause the Bank System to fail to
9 meet its obligation under the REFCorp Provisions of the Bank
10 Act to contribute the debt service for the obligations
11 issued by REFCorp.

12 Prior to the enactment of the Gramm-Leach-Bliley
13 Act, the Bank Act had required the Banks collectively to pay
14 \$300 million annually toward the debt service on obligations
15 issued by REFCorp. The Gramm-Leach-Bliley Act amended the
16 Bank Act to require each Bank annually to pay 20 percent of
17 its net earnings toward the debt service on obligations
18 issued by REFCorp. This is effective as of January 1, 2000.

19 Since that time, the obligation of the Bank System
20 to contribute toward the REFCorp debt service under the Bank
21 Act will be satisfied so long as each Bank contributes 20
22 percent of its net earnings to REFCorp each year regardless
23 of the amount of the net earnings for each Bank for that
24 year. The Gramm-Leach-Bliley Act also requires the Finance
25 Board to extend or shorten the period of time that each Bank

1 shall be required to pay 20 percent of its net earnings to
2 REFCorp or Treasury if the payment period is extended as
3 necessary to ensure that variations in the net earnings of
4 the Banks do not alter the Banks' total obligation to
5 REFCorp when calculated on a present value basis and
6 measured against a benchmark annuity.

7 So even if the withdrawal of members were to cause
8 the Banks' REFCorp payments to fall short of the benchmark
9 annuity for a particular year, there is no way that member
10 withdrawals could cause the Banks to fail to meet their
11 obligation to contribute 20 percent of their net earnings to
12 REFCorp. The only result would be that the Finance Board
13 would have to extend the period of time over which the Banks
14 would be required to make their REFCorp payments.

15 In short, the Banks could never fail to comply
16 with their REFCorp obligation because the formula is based
17 solely on a percentage of net earnings rather than on a
18 fixed dollar amount, as had been the case previously.
19 Therefore, the Finance Board may safely issue a blanket
20 certification on the withdrawal of a Bank that the
21 withdrawal of a Bank member will not cause the Bank System
22 to fail to meet its obligation under the REFCorp Provisions
23 of the Bank Act to contribute to the debt service for the
24 obligations issued by REFCorp.

25 So there is a resolution to that effect in your

1 Board book. And if you have any questions, I'll be happy to
2 answer those.

3 MR. MORRISON: It says that Congress provided for
4 belt and suspenders, and there will always be a belt.

5 MS. SILBERMAN: Indeed, and suspenders.

6 MR. MORRISON: All right. I move that the
7 resolution be adopted. Are there any questions or comments?

8 Okay. All in favor, please say "aye."

9 (Chorus of ayes)

10 MR. MORRISON: Opposed, no. The ayes have it.
11 The resolution is agreed to. The meeting is adjourned.

12 (Whereupon, at 10:45 a.m., the meeting was
13 adjourned.)

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REPORTER'S CERTIFICATE

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DOCKET NO.: N/A
CASE TITLE: FEDERAL HOUSING FINANCE BOARD / OPEN MEETING
HEARING DATE: June 23, 2000
LOCATION: Washington, DC

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

Date: June 23, 2000

Sharon Cook
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