

IN THE FEDERAL HOUSING FINANCE BOARD

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

Wednesday,
December 20, 2000

The parties met, pursuant to the notice, at
10:03 a.m.

APPEARANCES:

- WILLIAM C. APGAR, ACTING CHAIRMAN
- J. TIMOTHY O'NEILL, DIRECTOR
- FRANZ S. LEICHTER, DIRECTOR
- JAMES L. BOTHWELL
- NEIL R. CROWLEY
- DEBORAH F. SILBERMAN
- SCOTT L. SMITH

P R O C E E D I N G S

(10:03 a.m.)

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3 MR. APGAR: We just have one item on our agenda
4 today, the final rule on capital requirements for the
5 Federal Home Loan Banks. And, Jim, could you summarize the
6 ruling? I know Scott probably --

7 MR. BOTHWELL: Yes.

8 MR. APGAR: Only the rules.

9 MR. BOTHWELL: Yes, Mr. Chairman. Good morning,
10 and good morning, Director O'Neill, Director Leichter. As
11 you are aware, there is one item on the agenda for the
12 Board's consideration today. In the context of the Federal
13 Home Loan Bank's System 68 year history, one might even say
14 it was a very historic item on the agenda today, which is
15 the adoption of the final rule to implement an entirely new
16 risk-based and permanent and capital structure for the
17 Federal Home Loan Banks.

18 Before I ask Scott Smith, who is the acting
19 director of the Policy Office, and Neil Crowley, our deputy
20 general counsel, to present this item, I would just like to
21 note that the rule is a product of an extremely extensive
22 and intensive effort on the part of the entire Finance Board
23 staff to develop a state-of-the-art set of risk-based
24 capital requirements. Once implemented, these requirements
25 should help to ensure the safety and soundness of the

1 Federal Home Loan Bank System for years to come.

2 This rule is also the last Finance Board action
3 necessary to implement all of the major provisions of Title
4 VI of Gramm-Leach-Bliley legislation, which as you know was
5 enacted on November 12th of last year. So with the adoption
6 of this final rule of the Finance Board, we'll have all the
7 major requirements of this landmark legislation in just
8 slightly over one year's time, which I believe is quite an
9 achievement for the Finance Board.

10 So without further fanfare, I would like to ask
11 Scott and Neil to present the rule for the Board's
12 consideration this morning.

13 MR. SMITH: Thank you, Jim, and good morning, Mr.
14 Chairman and Directors Leichter and O'Neill. Staff is
15 requesting that the Board of Directors consider and approve
16 the final rule on capital requirements for the Federal Home
17 Loan Banks. This rule will implement an entirely new
18 capital structure for the Banks as required by the Gramm-
19 Leach-Bliley Act.

20 Specifically, the rule addresses the different
21 classes of stock that a Bank may issue and the rights and
22 preferences associated with each class of stock that a Bank
23 may impose. It also establishes new requirements for total
24 capital and risk-based capital and addresses the capital
25 structure plans that each Bank must submit for Finance Board

1 approval.

2 As envisioned by the Gramm-Leach-Bliley Act and as
3 presented in the final rule, the new capital structure for
4 the Federal Home Loan Bank System will modernize the
5 existing capital structure in a number of important ways.
6 Central to this modernization of the Bank's capital
7 structure is the introduction of a risk-based capital
8 requirement. When fully implemented, the risk-based capital
9 requirement will establish a direct relationship between
10 each Bank's capital and risk level, replacing the current
11 subscription capital structure where the amount of capital
12 each Bank is required to hold bears little relationship to
13 the risk posed by the Bank's activities.

14 Furthermore, Gramm-Leach-Bliley established four
15 principles on how the risk-based capital requirement is to
16 be determined and provided the Finance Board the flexibility
17 to design in the final rule a state-of-the-art risk-based
18 capital requirement and then to update that design as
19 needed. The fact that the rule applies only to the 12
20 Federal Home Loan Banks, where all have similar business
21 activities and are required to maintain a double-A or better
22 stand-alone rating of financial strength, allowed for risk-
23 based capital requirement design that is based on objective
24 measures of the actual credit and market risks faced by the
25 Banks.

1 To provide permanent capital, which must be used
2 to meet the risk-based capital requirement and is required
3 by Gramm-Leach-Bliley, the rule authorizes the Banks to
4 issue Class B stock, which derives its currency from the
5 fact that it is redeemable only on five years notice to the
6 Bank, whereas the current stock is redeemable on six months
7 notice.

8 The rule and Gramm-Leach-Bliley also authorize the
9 Banks to issue Class A stock, which is redeemable on six
10 months notice, and therefore not considered permanent
11 capital, but nonetheless provides the Banks with flexibility
12 to efficiently manage their capital in meeting the Gramm-
13 Leach-Bliley requirements incorporated in the rule.
14 Flexibility is also provided by Gramm-Leach-Bliley and in
15 the rule with respect to an activity-based stock purchase
16 requirement.

17 Currently, in pre-Gramm-Leach-Bliley and by pre-
18 Gramm-Leach-Bliley statute, it exists -- stock requirement
19 advancing, notably excluding anything else. This
20 requirement is not appropriately calibrated to the risk of
21 the advances. In the final rule, the Banks are given the
22 flexibility, with Finance Board approval, to design
23 activity-based stock purchase requirements that can be
24 applied to all activities, including AMA loan purchases, and
25 that are calibrated to the risk of the activity.

1 During the comment period on the proposed rule,
2 which ended November 20th, the Finance Board received over
3 140 comments on the proposed rule. In addition, the Finance
4 Board has been proactive in obtaining comments through
5 meetings and conferences with the Banks, members, and many
6 of the associations that represent members. Overall, the
7 comments suggested changes that were intended to achieve
8 greater commonality among the capital structure plans of the
9 different Banks to preserve the cooperative nature of the
10 System, also to improve the workability of the plans and to
11 maintain flexibility to accommodate the evolving nature of
12 business activities.

13 The final rule reflects many changes from the
14 proposed rule based upon the comments received. To achieve
15 some degree of commonality and reinforce the cooperative
16 nature of the System, the final rule now requires both Class
17 A and B stock to be issued, repurchased, or redeemed at par,
18 where par is established by each Bank and their capital
19 plan. Furthermore, no class of stock may be traded between
20 members or at a negotiated price, and the design of the
21 directors and -- I'm sorry, and the designation of directors
22 and voting for directors shall be in accordance with
23 existing rules as modified to accommodate two classes of
24 stock instead of one, and modified to allow the Banks an
25 ability to impose a voting preference.

1 Also, the final rule now prohibits a Bank from
2 imposing membership fees in lieu of any minimum stock
3 purchase requirement. To achieve workability, particularly
4 with respect to the ability of the Banks to manage their
5 capital levels, the final rule now requires that Banks shall
6 require that members must hold any activity-based stock
7 purchases for the period in which the activity is
8 outstanding.

9 Also, the final rule now allows the Banks at their
10 discretion to repurchase stock at par, much as the Banks do
11 now under current rules. And eliminated from the final rule
12 are any limitations on the requirements of members to
13 purchase activity-based stock, as were contained in the
14 proposed rule associated with operating capital ratios and
15 through limits on stock ownership.

16 With regard to the risk-based capital standards,
17 the final rule now contains clarifying language and approved
18 methods for determining risk-based capital charges.

19 Finally, to add flexibility, the rule now permits
20 Banks to require the purchase of either Class A or B stock
21 rather than just Class A stock to satisfy any membership
22 based stock requirement. In addition, the final rule no
23 longer requires that Class A stock receive a stated dividend
24 or that it have priority over Class B; instead, to leave
25 such decisions up to each Bank to address in their capital

1 plans.

2 The final rule and the Gramm-Leach-Bliley Act
3 together require that there exists some degree of
4 commonality among the different Bank capital plans.
5 Nonetheless, the rule also affords the Bank significant
6 flexibility to design a capital structure that best meets
7 the needs of their membership. Should the Board approve the
8 final rule, as specified in the Gramm-Leach-Bliley Act, the
9 Banks will have 270 days from the date of publication of the
10 rule in the Federal Register to submit their capital plans
11 to the Finance Board for approval.

12 During the approval process, staff will be
13 examining the Bank's individual plans to ensure that they
14 comply with the requirements of Gramm-Leach-Bliley and the
15 final rule and do not inadvertently introduce any elements
16 of instability into the System.

17 We would be happy to answer any questions.

18 MR. APGAR: All right. Now as you know, I have a
19 related proposal to this rulemaking, which I have already
20 shared with both of my colleagues here, and it relates to
21 the Board's willingness to and our ability to respond to
22 unforeseen issues that may arise as the rule is put into
23 place. We understand this is a complex undertaking, and
24 that the individual -- both the members and the Banks will
25 perhaps identify issues not contemplated by the rule as they

1 go into the process of finalizing their capital plans. And
2 we wanted to make sure we maintain flexibility on our part
3 to address any possible concerns going forward.

4 So I'm going to withhold this proposal back -- so
5 we can first move to the business at hand of -- voting on
6 the capital rule itself. So any questions to lead off with
7 in terms of proposed rule?

8 MR. LEICHTER: I don't have any questions. I
9 spent a good deal of time with the staff reviewing the
10 rules, and my questions have been answered. I do have some
11 comments I want to make, but I'll make it afterwards.
12 Director O'Neill had some questions.

13 MR. APGAR: So we can have a quiz as to whether
14 you know the top ten issues that we have talked on and on
15 and on about.

16 MR. LEICHTER: That's the old professor coming out
17 in the Chairman.

18 (Laughter)

19 MR. LEICHTER: He likes to give tests.

20 MR. APGAR: There you go.

21 MR. LEICHTER: But short answer or essay?

22 MR. APGAR: But as you heard in the presentation
23 of the rule itself, there are obviously some themes that we
24 heard over and over again in our public meetings and in the
25 comments through all this the importance of commonality and

1 maintaining the cooperative nature of the System, and the
2 kind of responses that we made there, I think, are
3 reflective of those concerns.

4 Ultimately, they had to be workable for the Banks,
5 flexible. This whole era is devolving significant
6 authorities to the Banks, maybe more authorities than they
7 are prepared to use at present. But whatever they have,
8 they have to have the flexibility to do it in a framework of
9 rulemaking that makes it workable, and they also -- the old
10 adage of keeping it simple and making sure that in this
11 period of transition there are some simple pathways that
12 Banks can utilize in order to move to the new era of risk-
13 based capital.

14 So I think those were the heart of many of the
15 comments we got. And each of the individual adjustments
16 that careful readers will see between the original rule and
17 the proposed rule and the final rule reflect those kind of
18 adjustments. So I think it makes the rule an enhanced
19 vehicle. There is a good reason why you have notice and
20 comment rulemaking, because the rule can improve when other
21 people look and comment on it.

22 So do you have any thoughts or observations?

23 MR. O'NEILL: Well, just a comment. I think Scott
24 Smith had a word that has epitomized this whole process,
25 which is proactive. When I thought to myself that the

1 comment period was closing on November 20th, and we were
2 going to vote on it on December 20th, I said there is no way
3 that the staff could look over all of the comments, put
4 together a comment summary, change the rule, and turn it
5 around in one month.

6 But I think the reason that they have and they
7 have done the usual superb job is that they have been
8 proactive. And I hope that this regulation will point us in
9 the way of the future because not only did the staff do a
10 lot of good work, but the staff worked with the Banks and
11 the members and non-for-profits, and so this is not
12 something that we did by ourselves and are now for the first
13 time unleashing on the Banks. The Banks have looked at this
14 and have made the comments. We have taken a lot of the
15 comments.

16 So I want to compliment the staff not only --but
17 for being proactive because they worked very hard. I want
18 to thank the staff for all that they did.

19 MR. APGAR: Any further comments? Before we vote.

20 MR. LEICHTER: Yeah. I know, we talked about the
21 Federal Home Loan Bank System being a cooperative System.
22 And I think the rule that we are about to enact maintains
23 the cooperative nature of the System. It evolved and is
24 being adopted today -- cooperative nature of the System. We
25 would not be able to accomplish this without -- Federal

1 Housing Finance Board, then the cooperation and the work of
2 the Banks and its presidents, the contribution -- and all of
3 the commentators.

4 So it really was a cooperative effort that brought
5 this. I think we're adopting a rule which carries out the
6 letter and the spirit of Gramm-Leach-Bliley. And I think
7 this heralds an era for the Federal Home Loan Bank System by
8 the foundation for the System to further its mission.

9 The capital plans which -- able to will replicate
10 features of the present System which -- of the System are
11 familiar with and features and characteristics which have
12 permitted the System's dramatic growth in recent years. At
13 the same time, we are creating new opportunities and
14 potential for the System to enhance its service and provide
15 liquidity to America's financial institutions.

16 The new capital plans for which the rule permits
17 and will be formulated pursuant to its provisions will
18 hopefully also advance the System's ability to support
19 community development staff. To paraphrase a quote of
20 Churchill, this is not the end of the process or even the
21 beginning of the end, but it is the end of the beginning.
22 What this board has made clear and what the Chairman-Elect
23 O'Neill had said is that we're going to be ready to continue
24 to work cooperatively with all of the participants to see
25 that the rule is fine tuned as the Banks -- that we need to

1 address. And I think we have put in place a mechanism which
2 is going to allow us to do this in an orderly manner and to
3 be very responsive to the Banks as they work to formulate
4 their capital plans.

5 I just want to point out that while we may have
6 taken a little more time than Congress initially set, the
7 fact that we did this so -- in such an expeditious manner --
8 and I think it was expeditious. I just compare this to what
9 I read yesterday of a sister regulatory agency that I think
10 after eight years was able to accomplish a mandate that was
11 given to it to produce -- relations that we're enacting
12 today.

13 Now I say this not to criticize the sister agency
14 but to say what a wonderful and excellent job really the
15 staff has done. I mentioned before the staff generically,
16 and they certainly all deserve great credit, and so many
17 people labored anonymously. But I just want to express my
18 personal appreciation because of the help they have given me
19 in understanding the rule and for the work they have done,
20 Jim Bothwell and Scott Smith and Neil Crowley and Deborah
21 Silberman.

22 Again, not to in any way diminish the work that
23 all of their supporting staff did, it really was a
24 remarkable achievement. And, Mr. Chairman, I just must
25 acknowledge your leadership in this. And I think among the

1 many contributions is that you set a tone which I think
2 enabled this process to move ahead in this cooperative
3 fashion. And I think without that having been done, it
4 wouldn't have been achieved. And Director O'Neill, who
5 brings so much knowledge and wisdom to this process, and
6 certainly his great help to me in working through these
7 capital rules.

8 I just want to point out that when I first came on
9 the board, which was the beginning of August, the capital
10 rules loomed like some terrible storm on the horizon that
11 was going to break over the System, and the feeling was
12 there was no way that we could do this for many months. And
13 there was a great deal of concern. And all of those clouds
14 have really dissipated, and we have seen that we have been
15 able to come up with these capital rules. And I think they
16 will really provide the basis to not only modernize the
17 System but to strengthen it.

18 So I'm very pleased to join with my fellow
19 directors and with everybody in voting in favor of these
20 rules.

21 MR. O'NEILL: Can I just add two additional
22 things? One -- actually, both points following up on what
23 Franz said. First, I was remiss in not recognizing the role
24 of the Chairman. I agree with Franz that there is a whole
25 new atmosphere not only at the Finance Board but throughout

1 the whole Federal Home Loan Bank System. And I think that
2 that is attributable to you. And I want to thank you for
3 that. I think that there is a new attitude, and I think
4 that everybody has prospered under the new attitude.

5 The second thing is that Franz is right, that this
6 is not the end of the process by any means. And we have a
7 resolution to go with the approval of this. And what that
8 resolution says is by the end of February that the staff
9 would put together advanced notice of proposed rulemaking
10 about all of the things that are left to do. And I think
11 that sends a great signal to the System that we're not just
12 saying, oh, our work now is finished. It is all to you to
13 implement this, that we are going to work cooperatively with
14 the Banks and the members to continue to make this the
15 absolute best rule that it could be.

16 So I think that is a great signal to send
17 everybody, that this is not the end of our work. So I think
18 that is very important to send that signal.

19 MR. APGAR: Great. Any other comments or
20 questions before we take a vote? If not, the vote occurs on
21 the adoption of the final capital rule. All in favor of
22 adoption of the final rule, please say aye.

23 MR. O'NEILL: Aye.

24 MR. LEICHTER: Aye.

25 MR. APGAR: Any opposed? I guess not. The ayes

1 have it, and the final capital rule is adopted. Great. I
2 ask unanimous consent that staff be permitted to make
3 technical and conforming changes in the rule. Without
4 objection, so ordered.

5 I just wanted to sort of characterize a little bit
6 about the resolution. There has been a lot of talk and, of
7 course, consternation. We talked about the kind of Catch-22
8 quality of what we are doing. Without a detailed capital
9 rule, of course, individual Banks cannot begin to finalize
10 their capital plan. Without finalizing the capital plan,
11 some important accounting and tax rulings would be
12 forthcoming. Of course, other regulatory agencies might
13 have actions that they could contemplate could affect the
14 implementation of the final rules. So there is lots of
15 issues here that have to occur simultaneously.

16 So we wanted to signal, as we have been signalling
17 throughout, our intention to stay flexible, keep an open
18 mind, and continue the work of the Banks as they move
19 through this next 270 day transition period. So in order to
20 do that, you know, we have conducted an open process, and we
21 think the rule reflects well this process. But it won't be
22 perfect. There will be things that are unanticipated that
23 will occur. We want to keep our options open as to how to
24 respond to that, and the question of what is the appropriate
25 mechanism to do that so that we will be able to quickly

1 respond to any issues that might arise.

2 And we have drafted a proposal. So I offer this
3 proposal, which is in the form of a resolution to the Board.
4 It does two things. First, it commits to the task of
5 monitoring the tax accounting and other issues association
6 with the capital rule, and to the extent consistent with our
7 primary duty, to ensure the safety and soundness of the
8 Banks, to act promptly to address those issues as they
9 arise; and second, to direct the staff to develop for the
10 Board's consideration -- and again it is noted no later than
11 February 28, 2001 -- an advanced notice of proposed
12 rulemaking to seek information and comment on any issues
13 about the capital rule or capital planning process where
14 actions of these other regulatory agents -- or anything at
15 all that would affect the smooth implementation of the rule,
16 as was adopted today.

17 I know you have reviewed this. More
18 appropriately, you have both helped write this. So -- but
19 if there is any comments or discussions on this proposal, it
20 has been distributed to you both. So --

21 MR. O'NEILL: No. I think it is perfect the way
22 it is.

23 MR. APGAR: Perfect the way it is, okay. So we
24 come out on a high note on that. Okay. If there are no
25 objections to this perfect resolution, the vote occurs on

1 the Board resolution. All in favor, please say aye.

2 MR. O'NEILL: Aye.

3 MR. LEICHTER: Aye.

4 MR. APGAR: And no opposed. So the resolution is
5 adopted. And thanks again for the work. And I guess the
6 new era of the Federal Home Loan Bank System and the new
7 work of the Federal Housing Finance Board is begun. The
8 meeting is adjourned.

9 (Whereupon, at 10:28 a.m., the meeting was
10 adjourned.)

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DOCKET NO.: N/A
CASE TITLE: CAPITAL REQUIREMENTS FOR FHL BANKS
HEARING DATE: December 20, 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: December 20, 2000


Gabriel Thomas

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