FEDERAL HOUSING FINANCE BOARD

OPEN SESSION

Wednesday, June 23, 2004
Washington, D.C.

The Board convened, pursuant to notice, at 10:07 a.m., at 1777 F Street, N.W., Second Floor Board Room, Washington, D.C.

MEMBERS PRESENT:

ALICIA CASTANEDA, Chairman
ALPHONSO JACKSON, Secretary, U.S. Department of Housing and Urban Development
JOHN C. WEICHER, Director
ALLAN L. MENDELOWITZ, Director
FRANZ S. LEICHTER, Director

P R O C E E D I N G S

CHAIRMAN CASTANEDA: Good morning everybody. It is a pleasure to see all of you. The meeting of the Board of Directors of the Federal Housing Finance Board will please come to order.

Before we enter into today's business, allow me to welcome Alphonso Jackson, the Secretary of the U.S. Department of Housing and Urban Development. Good morning, Mr. Secretary. It is an honor for us that you agreed to participate in today's Board meeting. Secretary Jackson is a member of the Federal Housing Finance Board, but it is traditional that he assigns his able and dedicated designee, Commissioner John Weicher, to represent him on the Board. Good morning John.

Yet it seems to me that Secretary Jackson has taken a special interest in the operations of this agency. I know that back in his days in charge of supervising housing authorities in Dallas and Washington, D.C., he worked with the Federal Home Loan Banks and their Affordable Housing Program, which the Finance Board oversees as a regulator.

In fact, this the third time the Secretary has joined us in person at the Finance Board, which is certainly a record number of visits by a Secretary. He spoke to us

during African American History Month, telling the powerful and wonderful personal history – and at my swearing in ceremony. I am very grateful for his presence on both days. And I'm grateful for his presence today. Now, I know he has a tight schedule and cannot stay with us through the entire meeting, but I want to again thank him for his interest in today's final rule and support for enhanced disclosure at the Federal Home Loan Banks.

Mr. Secretary, is there anything you would like to say?

SECRETARY JACKSON: No, thank you.

CHAIRMAN CASTANEDA: Just go on with the agenda?

SECRETARY JACKSON: Yes.

CHAIRMAN CASTANEDA:

The first part of today's agenda is an open session. Followed by a closed session to receive an update of examination program development and supervisory findings.

Before we can move into the open session, we need to take care of a procedural issue under the Government in the Sunshine Act. The Sunshine Act requires a public vote to approve closing the meeting to public observation and withholding the transcript of the meeting from the public. The closed portion of today's meeting will consist of an

update of examination program development and supervisory findings.

The presentation and discussion will include Bank examination and supervisory information that is sensitive and confidential. And the General Counsel has certified that it is proper to close the meeting and withhold the transcript from the public.

I now ask for a motion to approve closing the latter portion of today's meeting from public observation and withholding the transcript from the public. Director Leichter?

DIRECTOR LEICHTER: Yes, thank you.

And just before I do, with your indulgence, Madame Chair, if I could also join in welcoming Secretary Jackson. You've become something of a regular visitor here. And we're delighted. I think you underscore the important work that we do and particularly the action we take today. And I hope we'll continue to have your presence and benefit from your working with us. Thank you very much, Secretary Jackson.

SECRETARY JACKSON: Thank you very much.

DIRECTOR LEICHTER: Yes. Let me make the following motion. Under the Government in the Sunshine Act and the Finance Board's implementing regulations, the

General Counsel has certified that it is proper to close public observation and withhold from the public the transcript of the portion of today's meeting concerning an update of examination program development and supervisory findings. Based on the subject matter and in reliance on the General Counsel Certification, I move to close that portion of our meeting and withhold the record from the public.

CHAIRMAN CASTANEDA: Thank you for the motion.

Is there any discussion of the motion?

[No response.]

CHAIRMAN CASTANEDA: Seeing none, the Secretary will please call the roll on the motion to close the meeting.

MS. GOTTLIEB: On the motion before the Board, Director Leichter, how do you vote?

DIRECTOR LEICHTER: Yes.

MS. GOTTLIEB: Director Mendelowitz?

DIRECTOR MENDELOWITZ: Yes.

MS. GOTTLIEB: Secretary Jackson?

SECRETARY JACKSON: Yes.

MS. GOTTLIEB: Chairman Castaneda?

CHAIRMAN CASTANEDA: Yes.

The motion is carried.

We will now go to the first agenda item for the open portion of our meeting, consideration of a final regulation to require each Federal Home Loan Bank to register a class of its securities with the Securities and Exchange Commission under the provision of section 12(g) of the Securities Exchange Act of 1934.

We have with us Dr. Steve Cross, Director of the Office of Supervision, and Mark Tenhundfeld of our General Counsel. Gentlemen?

MR. TENHUNDFELD: Thank you, Chairman Castaneda and Secretary Jackson and the other Directors. I appreciate the opportunity to present the views of the Office of General Counsel on the issue of whether the Finance Board has the legal authority to require the Federal Home Loan Banks to register a class of equity securities with the SEC.

Before addressing that issue, I'd like to acknowledge the efforts of several members of my staff, including Neil Crowley, Harry Jorgenson, John Foley, Sharon Like, Tom Joseph, Tom Hearn, Mary Gottlieb, and Shelia Willis. Each of these people have made significant contributions on this project. And I very much appreciate their efforts.

On September 17th of last year, the Finance Board published for comment a proposal that would result in the 12

Home Loan Banks registering securities with the SEC under the SEC's voluntary registration provision of Section 12(g) of the Securities Exchange Act of 1934. The Board received 24 comments, most of which supported enhanced disclosures as a general proposition, but opposed the requirement that the Banks register with the SEC.

A fundamental issue raised by the commenters is whether the Finance Board has the legal authority to require the Banks to register with the SEC. As discussed more fully in the Office of General Counsel memorandum that has been distributed to the Board, this issue has two related but distinct facets.

First, does the Finance Board have the authority under the Federal Home Loan Bank Act to require registration with the SEC? And second, is the rule a proper exercise of that authority?

Turning first to the authority under the Bank Act, Section 2(a) of that Act directs the Finance Board as its primary duty to ensure that the Federal Home Loan Banks operate in a financially safe and sound manner. To the extent consistent with that primary objective, the Finance Board also is to ensure that the Banks carry out their housing mission and remain adequately capitalized and able to raise funds in the capital markets.

Congress has provided the Finance Board with sweeping powers to fulfill these duties, including the power to promulgate and enforce such regulations as are necessary to carry out the provisions of the Bank Act. Thus, any rule that has the purpose or effect of enhancing the safe and sound operations of the Banks or their continued access to the capital markets is within the authority vested in the Finance Board.

The record before the Board contains ample evidence of the benefits of enhanced disclosures and their likely impact on Bank operations. Stated very briefly, the record contains an analysis of Federal Home Loan Bank disclosures in which staff concluded that those disclosures fall short of what is required under the 1934 Act. It also contains a discussion of a study conducted by staff at the Federal Reserve Board and a report of the Basel Committee on banking supervision, both of which conclude that enhanced disclosures have a beneficial impact on market discipline.

Required disclosures that meet the standards set out in the 1934 Act would result in more and better disclosures. The resulting increased transparency would be likely to promote a greater degree of market discipline which, in turn, would contribute to the safety and soundness of the Banks by eliminating differences in the quality of

the Banks' disclosures when compared to those of their competitors. Enhanced disclosures would further the Finance Board's duty to ensure that the Banks are able to access the capital markets. Thus, requiring enhanced disclosures clearly is within the Board's authority under the Bank Act.

The next question is whether the rule is a proper exercise of that authority. We conclude that it is. To put that conclusion in perspective, it is helpful to review briefly the standard to which the Board's actions would be held upon review by a court. Under the leading Supreme Court case of Chevron v. Natural Resources Defense Council, the court will ask, first, whether Congress has spoken to the precise question at issue. If it has, the agency must give effect to the unambiguously expressed intent. If Congress has not, the court will proceed to the second step of the analysis, namely, whether the agency's interpretation is reasonable. A court will show deference to an agency's decision even if the court would have reached a different conclusion provided that the decision is a permissible interpretation of the underlying statutes.

Congress has not spoken to the precise question at issue. While the Bank Act vests broad powers in the Finance Board, it does not address the question of the level and type of disclosure that the Finance Board may require of the

Banks. Similarly, there is no expressed coverage of or exemption for Federal Home Loan Bank equity securities under the 1934 Act. Thus, a court would analyze whether the Finance Board's decision to require SEC registration is a reasonable accommodation of conflicting policies that are committed to the agency's care.

As previously noted, the record clearly demonstrates the benefits of and the commenters' support for enhanced disclosures. The question thus becomes whether it is reasonable for the Finance Board to use the SEC's disclosure regime to achieve these benefits.

As will be explained by Dr. Cross in his remarks, in his view the better course is to require registration with the SEC. For the reasons he will outline, the record supports a finding that the benefits of SEC registration outweigh those of a Finance Board administered disclosure regime.

Commenters raised two other legal issues that I would like to address briefly. The first is that by requiring registration with the SEC, the Finance Board will be overturning a statutory exemption. However, the securities laws and the Bank Act are silent about the registration of Bank equity securities under the 1934 Act. Accordingly, a decision by the Board today to approve the

SEC registration rule would not conflict with any statutory provision.

The second issue is that the Finance Board would be impermissibly delegating its authority to the SEC. However, there is no delegation under the rule being considered. The Finance Board is and will remain the safety and soundness regulator of the Banks. Enhanced disclosures through registration of a class of Bank equity securities with the SEC are entirely consistent with the goal of Bank safety and soundness.

For the foregoing reasons, and as developed more fully in our written opinion, we are of the view that the Finance Board has the authority to require the Federal Home Loan Banks to register a class of equity securities with the SEC. The draft final rule before you today reflects that judgment.

In addition to requiring the Banks to register with the SEC, the rule establishes a deadline of June 30, 2005, by which Banks must file a registration statement to become registered and a deadline of August 29, 2005, for when the registration statement must be considered effective. The final rule preserves the authority of the Board to extend these deadlines if there is good cause to do so. The rule goes on to note that the Banks will be

obligated to comply with the periodic disclosure requirements of the 1934 Act and any other materials required pursuant to SEC rules, including those related to audited financial statements.

The final provision in the rule provides that the rule does not diminish or otherwise restrict the ability of the Finance Board to exercise any and all authority conferred on the Board by the Bank Act.

If the Board votes to adopt the final rule before you, I would respectfully request that the Board authorize Office of General Counsel staff to make non-substantive technical edits following approval, such as those that may be required by the Federal Register to conform the document to the Federal Register style conventions.

I want to thank you again for the opportunity to present the Office of General Counsel's views on the rule under consideration. And I will be happy to answer any questions you may have either now or at the completion of Dr. Cross' remarks. Thank you.

CHAIRMAN CASTANEDA: Thank you, Mark.

Steve, why don't you make your remarks and then we will go back if anybody has any questions.

DR. CROSS: Thank you, Chairman Castaneda and members of the Board. I, too, would like to begin by

recognizing the contributions of staff to the work before you. First, as referenced by Mr. Tenhundfeld, you have before you an extensive administrative record of materials for your consideration in acting. That record was largely compiled under the direction of Scott Smith, ably assisted by financial analysts in the Office of Supervision, Christina Muradian, Julie Paller, and Ellen Hancock. Each of them had an opportunity to comment on the OS position paper, as did Tony Cornyn and Dan Coates, who are senior advisors to me in the Office of Supervision, and Christie Sciacca, who is Deputy Director in the Office of Supervision.

That record includes testimony, research papers, analyses, and summaries of those research papers, examinations of current disclosure practices, and areas affected by enhanced disclosures. The record demonstrates that at the System level, the scope, form, content of disclosures are generally consistent with the requirements of the SEC regulations SK and SX. Some exceptions exist, such as the exception dealing with related party transactions. But those exceptions are principally due to the unique features of the Banks as cooperatives.

At the individual Bank level, the Finance Board rules provide that any financial statements contained in an

annual or quarterly report must be consistent in form and content with the financial statements presented in the combined statements, but otherwise do not require the disclosures to meet SEC standards.

Enhanced disclosures, therefore, would affect individual Bank disclosures probably more significantly than the combined disclosures. The record before you demonstrates broad support for enhanced disclosures at the individual Bank level. The Banks in their written submissions to the proposed rule and in testimony offered at an earlier hearing on the matter have committed to enhanced disclosures. A Federal Reserve staff paper from March 2000 expounds on the benefits to Bank supervision associated with enhanced disclosure. Indeed, we concluded that the principal issue facing the Board today was not whether disclosure should be enhanced, but rather who should administer the disclosure regime, the Finance Board or the SEC.

Arguments exist in support of either approach. Those arguments are presented in the materials compiled for you for the administrative record. But for the purposes of this meeting, I will summarize the key points.

The points in favor of a Finance Board administered regime include, first, superior knowledge of

the Federal Home Loan Banks. They are unique financial institutions and the staff at the Finance Board have years of experience dealing with them. Finance Board administration of disclosure review would allow the Finance Board to balance safety and soundness considerations with disclosure review. The combined disclosures already satisfy market participants as evidenced by the market's acceptance of the Bank's consolidated obligations. And so, perhaps, it's best for the Finance Board to administer the regime because they would be responsible for the combined statements and could make balanced judgments with respect to the disclosures of the individual Banks.

And finally, Finance Board administration, at least initially is an appropriate incremental change in that SEC registration can be pursued at a later time if the Finance Board administration proves inadequate.

Those are the principal arguments made in the materials before you in favor of a Finance Board administered regime.

There are also arguments made in favor of an SEC administered regime. First and foremost, the SEC is the Nation's functional disclosure regulator. This is their job. And their job involves revealing the disclosures of a wide range of industries and entities, including other

financial institutions and ultimately the other housing GSEs, Fannie Mae at present, Freddie Mac, once they have completed the restatement of their financial statements. The other housing GSEs have committed to SEC registration.

Departure from the standard practices followed by those other housing GSEs could lead, I'm not saying it would, I'm saying it could lead--this is one of the arguments made--the markets to draw distinctions no matter how unwarranted.

Third, the SEC reviews financial reports from a broad range of financial institutions, not just the housing GSEs, but all the large bank holding companies. Related to that, they have had a successful track record coordinating their actions with the other financial institution regulators. As the record demonstrates, we have met with staff from other regulators who have generally lauded the SEC for their cooperation with them. There is a widely publicized 1998 case involving Sun Trust in which there was a disagreement between financial institution regulators and the SEC about the appropriate accounting for loan loss reserves. Far from being a reason to question whether SEC administration of disclosures is appropriate, we concluded that it was, in fact, an argument in favor. The financial institution regulators were able to argue their interests

without restraint for why the institutions they supervise should for safety and soundness purposes be allowed to build their loan loss reserves beyond the level that the SEC had anticipated at that time. Since that time, there has been no such disagreement and there were no problems with other large financial institutions.

Tension can exist, but it can be a healthy tension. And SEC oversight of the disclosure regime allows the safety and soundness regulator to argue its case unfettered by an effort to balance the benefits of disclosure on the one hand and safety and soundness on the other.

SEC has the staff in place already to quickly implement a disclosure regime. SEC has indicated that they would not have to add staff for this purpose. Staff is in place. The Finance Board would have to add additional staff in order to establish a disclosure regime.

Finally, we looked at issues of costs. There was a widely cited study included in the submissions of a number of the Banks that expressed concern about the costs to the Banks if they were required to register with the SEC. Included in your paper is an analysis of that study. It concluded that the costs were largely unfounded and speculative. And they arise from low probability events

that were unlikely to occur. They were largely based on worst case scenarios. And they didn't distinguish between the costs that will be associated with enhanced disclosures irrespective of who or which agency is administering the disclosure regime. Hence, they were really not estimates of the costs SEC registration. They were estimates of the costs of disclosure. And they weren't estimates of expected cost. They were estimates of costs in worst case, low probability, highly unlikely scenarios.

Indeed, the study itself indicated that Fannie Mae had registered "without apparent incident in this regard." In other words, despite the experience of one housing GSE in registering with the SEC without the adverse implications studied by the case, the argument was made it was still possible. So at the end we concluded that those estimates of costs were speculative and not supported by the analysis in the record. So we concluded that we saw no reason to believe that SEC registration would unduly increase the costs faced by the Banks relative to any other enhanced disclosure regime.

On balance, as we looked at the arguments, as I said, you could look at them from many perspectives, we concluded that the stronger arguments favored SEC administration of the disclosure function, principally to

repeat that the SEC is the Nation's functional disclosure regulator.

Their rules and regulations governing disclosures are well-established. The disclosure review and investor protection is the SEC's principal function whereas it would be secondary for the Finance Board. SEC has the staff in place to perform the review. The Finance Board does not. The SEC staff would benefit from reviewing the disclosure of other housing GSEs and financial institutions and from being responsible for writing and interpreting their own disclosure regulations.

They have a track record of cooperation with other financial institution regulators. And in the end, legal accounting or safety and soundness barriers do not exist. The SEC has met with the Banks and the Finance Board to discuss legal issues that registration under the SEC 1934 Act might entail. They're working on those issues. And indications are they will be resolved mutually. The legal issues through a no-action letter from the SEC to the Banks. The accounting issues through review of the registration statements of the Banks on Form 10.

The Office of Supervision had no safety and soundness objections to SEC registration. And therefore,

recommends that the Board proceed with the regulation as proposed. Thank you.

CHAIRMAN CASTANEDA: Thank you, Steve, thank you, Mark, for an excellent presentation. I know you and your staff have put a tremendous amount of work into this effort and I know all my colleagues and I are very grateful.

Are there any questions?

[No response.]

CHAIRMAN CASTANEDA: Okay. Before we proceed to the vote, I have a few remarks that I would like to make.

When I became Chairman of the Finance Board in April, the issue of SEC registration has already been discussed at great length. As the presentation just noted, the Finance Board by 4 to 0 vote adopted the proposed rule last September. And the 120 day comment period expired on January 15 of this year. This time has put to good use. The Finance Board staff and directors have studied the issue, considered the implications, and laid a solid foundation for action.

The foundation includes the draft final rule, memorandums from the Office of Supervision, and legal opinion from the Office of General Counsel we have before us today. It also includes other materials staff previously had provided the Finance Board to aid in its consideration

of these issues, including a briefing book on background materials relating to various disclosure initiatives and their role in supervision and a binder of similar materials regarding the Federal securities laws and issues related to enhanced Bank disclosure.

So the records my colleagues and I have before us is extensive, comprehensive, and more than sufficient for our purpose. The Federal Home Loan Banks, their member institutions and others who supply comments raise a number of important issues. And I believe their input assisted the Finance Board staff and Directors in considering this matter in a complete fashion. And I'm grateful for their contributions.

Let me now turn the issue at hand. It has always seemed to me there were two parts to the Federal Housing Finance Board consideration on this issue. The first is the fundamental policy question. Should the Finance Board require, and if so, how enhanced financial and operational disclosure from the Federal Home Loan Banks to provide a more complete, more transparent description of these large and important institutions on a basis comparable to other GSEs and sophisticated financial institutions?

Next, assuming we answer the policy question with a yes, the second question is a legal one: whether the

Federal Housing Finance Board has the authority to require that enhanced disclosure registration with the Securities and Exchange Commission? The essential power of the Federal Housing Finance Board derives from the Federal Home Loan Act, which requires the Board to ensure that the Banks remain safe and sound and able to raise funds in the capital markets. The Office of General Counsel has concluded that under those Bank authorities the Finance Board can, indeed, require the Federal Home Loan Banks to register with the SEC as the means to achieve those requirements.

I firmly believe that the analysis prepared by our legal staff leaves no reasoned doubt that the Finance Board has full statutory authority to take the action pending before us.

In evaluating financial disclosures for the Banks, I am guided by several straight forward policy considerations, but also by my own professional experience as a banker. Transparency is a basic principle, of course. Given the size, growth, and complexity of the Federal Home Loan Banks, it is simply a priority to move toward improved disclosures. Disclosures that provide more information to member financial institutions, the public, and investors.

I also place a great deal of weight on safety and soundness. As the Basel Committee and many of our fellow

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 risk faced by the financial institutions in question. In short, a stronger market discipline from enhanced disclosure will complement the safety and soundness oversight of the Finance Board's Office of Supervision.

Another very important issue concerns the proper role and responsibility of GSEs, especially given the recent attention to corporate governance. The public, investors, and policy makers have become more demanding, and rightfully so. To meet those demands, I believe the Federal Home Loan Banks should be recognized as world class leaders in setting the standards for transparency, disclosure and corporate responsibility, especially because they are GSEs created by Congress to serve a public purpose.

Finally, there is a 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, including GSEs and other large financial institutions. Just as important, they must also be accepted as comparable by investors, regulators and the public.

I mentioned my banking experience earlier. I have been a fixed income trader. I have sold agency debt. I know firsthand that if your disclosures are not comparable, if there is even a tiny doubt in the investor's mind that your disclosures are not on the same level than other issuers in the market, you have lost confidence. As an issuer, your spreads will widen. You will finding yourself chasing the market. And your costs, of course, will rise. Your ability to raise funds in the capital markets will be compromised at the very least.

All of these considerations, as well as a review of past and current Federal Home Loan Bank disclosures lead me to the obvious conclusion that enhanced disclosures are necessary as a fundamental policy in safety and soundness.

To maximize the benefits of full transparency, responsibility and comparability across institutions, there is simply no substitute for registration and disclosure under the Securities and Exchange Act of 1934. I've reached that answer based on the policy consideration I just outlined and these facts. The SEC is a disclosure regulator specifically created by Congress to be responsible for financial disclosure. It's what the SEC does. The SEC is also the final arbiter of accounting and GAAP issues with unparalleled expertise in review in complex financial

disclosures as well as extensive experience in reviewing disclosures from a diverse range of large and complex financial institutions.

Therefore, to best complement our safety and soundness oversight, to ensure continued access to capital markets, and to send a clear signal to the markets and public through the quality and comprehensiveness of Federal Home Loan Bank disclosures, I see no alternative to registration and disclosure with the SEC.

Now, some have argued that over time the Finance Board could review the enhanced disclosures with the same degree of competence and expertise as the SEC. That is probably correct. But no matter how good a job the Finance Board does, I believe the market would continue to perceive a quality distinction between a Finance Board administered regime and a SEC administered one. Such a perception could well disadvantage the Federal Home Loan Banks' access to capital markets.

On an even more fundamental level, our primary job at the Finance Board is safety and soundness. Our eyes and efforts are and must remain targeted toward our safety and soundness responsibility. I believe this. Creating and administering a disclosure regime equivalent to the SEC's would be unwise. And that to do so will divert the Finance

Board staff and resources from our core safety and soundness objective. And as made clear in the staff's presentation, it's also unnecessary.

All these reasons explain why I intend to vote without any doubt for the regulation under consideration today. I should note the Federal Home Loan Banks raised a number of legitimate operational issues stemming from the unique nature of the System. Their input was invaluable both before and during the comment period. And I thank them.

Based on discussions Finance Board personnel had had with the Federal Home Loan Banks and the SEC, I understand that these operational issues had been resolved either by the SEC through prospective no-action and other relief or by the Finance Board. These issues, therefore, cannot fairly be said any longer to pose an obstacle to our adopting the pending regulation.

As for timing, I believe the regulation strikes an appropriate balance between providing a reasonable time, more than one year from today, for the Banks to have an effective registration in place, while also signaling to the markets that the System is serious in improving its disclosures and securing the attendant benefits for the System and the public as soon as reasonably possible.

We have given great consideration to these issues. And I think we have done a good job in balancing the competing concerns.

I also wanted to acknowledge the cooperation and assistance in this process from the SEC and its staff. They have been extremely helpful and responsive. I'm fully confident that our agencies will work to resolve any issues that might arise following adoption of our regulation today.

We have traveled a long road on this issue. And I suppose that journey will continue with the actual process of registration. Still, today represents a significant milestone for the Federal Housing Finance Board, the Federal Home Loan Banks and the strength and transparency of this Nation's housing finance system.

With that, I will ask my colleagues if anyone has any statement they would like to make? Director Leichter?

DIRECTOR LEICHTER: I would like to defer to Secretary Jackson who has a comment.

SECRETARY JACKSON: Thank you very much.

DIRECTOR LEICHTER: Thank you, Madame Chair.

This is certainly a significant day in the history of the Federal Housing Finance Board. First of all, it's the first time I'm advised that the Secretary of HUD has ever participated in a Board meeting. And that underscores

the importance of the work that we're doing today. We're also bringing to an end what has been a very contentious, I may say, often unnecessarily so and difficult and painful process. And I think we're taking a very important action that I believe strengthens the Federal Home Loan Bank System.

Let me just make four quick points to begin. One is, I think there's no question that by this action we're achieving enhanced disclosure and we're achieving a level of transparency that presently does not exist and that I think strengthens and carries out the purpose and mission of the Home Loan Bank System.

Secondly, I believe particularly of late that we have worked out with the SEC operational issues, other questions, and that this has been done in such a manner that I think the Banks and others who have been concerned about the permanency and the degree to which one can rely on the SEC will, in fact, be set forth and is being set forth in such a manner that it will have permanence. I think we've achieved that. I feel comfortable that these issues have been worked out in a manner that will not impair the operations of the Home Loan Bank System.

Thirdly, we're showing that this Board can and will work together harmoniously.

And fourth, and I think it's an important point I want to make that I think none of this would have been possible except through the leadership that you provided, Madame Chairman. You've been very responsive to the points that I and other colleagues have made. We have had input into this process. We've proceeded in a collegial manner. You took on a process that I think had been difficult, and frankly had, in many respects, been flawed. And I think you've straightened it out and have brought us to this point where I think we can, with great confidence, move ahead and approve this resolution.

As I said, it's been a difficult process, and often unnecessarily so. This is not to say that there weren't some significant issues that needed to be worked out. But the issue has never been about transparency. I think all of us have been committed, and I know the Banks are committed, the Federal Home Loan Banks are fully committed to the best and fullest disclosure.

There may have been a number of ways to achieve this. Yes, it's possible that this could have been done in house by the Federal Housing Finance Board. But I think we've reached a point where a decision has to be made. And I think the decision to ask the SEC to participate, and I want to emphasize the word participate, in overseeing the

disclosure by the Federal Home Loan Banks is the proper step to take. And I want to say participate because this is not a strict divide in the responsibility of disclosure between the Federal Housing Finance Board and the SEC. The Federal Housing Finance Board will continue to be actively involved in overseeing disclosure. We will work with the SEC. We're not turning this over to the SEC and turning our back on the issue of disclosure. And the rule, of course, makes clear that we retain all of our authority and responsibility regarding disclosure.

But I think that in the last analysis it became clear to me that the imprimatur of the SEC was important. That was something that we could not provide. It was something that could really be accomplished best by having the SEC oversee disclosure through the filing that the Banks are going to make under the 1934 Act. So we're going to get better disclosure, financial conditions, result of operations, trends or uncertainties affecting the business of management of the Banks, assessment of the Banks' business and financial conditions, all of which will give greater information, greater transparency, not only to the market, but the Banks will have a better idea what the other Banks are doing. And they will be better able to impose

discipline upon themselves by having this degree of transparency.

We had a threshold issue which, frankly, has given me a lot of thought. I just want to say that while none of us asked any questions at this time of Steve Cross or Mark, you can be sure that throughout this process we have bombarded them with questions. We've had a countless number of meetings. I've spent more time on this issue than on any other issue. I know all my colleagues have given this very considered and thorough attention. And we have been thoroughly and fully briefed on all of the aspects of this issue.

But the legal issue was a difficult one. I think it's a very close question. And as you all know, Director Mendelowitz and I thought it was appropriate to go the Office of Legal Counsel and get a definitive legal opinion. I think that would have made a lot of sense. The majority of the Board decided that that was not what it wanted to do. And we are where we are. I must say I feel that in view of the closeness of the question, I paid very careful attention to legal memorandum that's been prepared by our Office of Legal Counsel. I think it's a very well-reasoned, thoughtful opinion. And under the circumstances, I will give the presumption to the opinion by our Office of Legal

Counsel. And I am acting -- feeling quite confident that we do have the authority to take this action.

The big issues that have been raised, and I want to say that the issues that have been raised have been legitimate issues. I know that some have snickered at the Banks and said, well, they just don't want to register, they don't want to have transparency. I think that's unfair. I think the Banks have acted in good faith. They've raised very legitimate issues because the Home Loan Bank System is a cooperative system. And because of statutory regulations and traditions and other provisions it doesn't really fit well into the SEC model. And it became necessary to work out a number of issues with the SEC. And the SEC Chairman has said, has certainly been cooperative in addressing these issues. And I think most, if not all, have been resolved.

Now, there was some concern by the Banks, and again, it was a legitimate issue that was raised, what is the permanence of the commitment that the SEC is making now? The SEC is going to enter into no-action letters with the Banks. And the form and content of those no-action letters, I'm advised, have been pretty well agreed on. And those no-action letters will accommodate those special features of the Home Loan Bank System insofar as SEC rules and practices are concerned.

There will also be an interpretive letter which will deal with what I call the four big issues, which is the REFCORP payment, the puttable stock, the Office of Finance, and I'm leaving out one of the four which escapes me at the moment. But these will be contained in the interpretive letter. But the question was raised, well, this is being issued at this time by the SEC. Can the SEC change its line under a different administration? And we have spent quite a bit of time working out that issue with the SEC.

Some of the commentators have suggested, well that this should really be done by the legislation. Well, legislation didn't pass at this session of Congress. It's not going to pass. So the legislative solution is not available to us.

I felt that, frankly, if we had had a memorandum of understanding with the SEC, that that would have been helpful. But, you know, the SEC is sort of a Mt. Olympus. We're just mortals. The SEC doesn't enter into agreements even with fellow regulators. And I want to say that effort was made. And I particularly want to acknowledge that our Chair went to the SEC and sought to get the sort of assurances that were needed. Now, while we didn't get the MOU, I think we have the assurances that the SEC will not

change the no-action letter, that the SEC will not change the commitments it's made in the interpretive statement.

And I want to make it very clear that I am voting for this rule in reliance on the commitments that the SEC made. And the SEC in a letter that it recently sent to the Board dated June 1 of this year, affirms statements made by Director Beller in testimony before the United States Senate Committee--Senate--Banking and Housing Committee. And so it's very clear that the commitments he made are not the commitments of Director Beller. These are the commitments of the SEC. They're binding. I consider them binding. I'm voting on reliance on these statements. So I believe that those concerns that the Banks have raised of whether the issues that we've worked out with the SEC can be unilaterally changed by the SEC, the answer is they cannot. The SEC has made it clear that before--if for any reason they feel that some of these need to be modified or changed, that they will communicate with us. They have made that commitment. We will be involved with the SEC. And we will be able to see that the interests of this System are protected and are understood by the SEC.

So I really think that the issues and concerns that have been raised have been worked out, they've been worked out in a satisfactory manner. And I think that we

can feel confident in going forward that we will not have problems in the System having access to the capital markets. That we will not have the SEC treat the Banks in a way that will impair their functioning. On the contrary, as I've said, I think this will strengthen the System. And by having SEC registration, I think there will be a confidence in the market that will be helpful to the operation and the mission of the System.

As I said before, we're not delegating our function and responsibility for disclosure to the SEC. This is a complementary process that we're entering into. And again, we will be very actively involved in monitoring and supervising disclosure by the Home Loan Banks. The effective date as you have seen has been moved to actually August 29, 2004, with filing on June 30th of 2004. We really believe that this is sufficient time for the Banks to work out any remaining issues with the SEC. And also to get the papers ready for the required filing.

However, if some unexpected event occurs, if it becomes necessary, the Board has the authority to extend the time. And the Board, this Board will work closely with the Banks to see that these time tables that we've set forth in the rule are met. And if problems occur, this Board is available to work with you and the SEC to work these out.

This is now a Board that believes in cooperation, not conflict, and communication, not confrontation. And I think we've shown that dialogue is better than divisiveness.

So Madame Chair, my fellow colleagues, after having given this issue a lot of thought and having had some sleepless time over this, I think we've brought the process to a point where I can in good conscience and in confidence vote to support this rule.

I just want to, before ending, I really do want to thank the staff. I know this has been a long and a difficult process. And we wouldn't be where we are here today without really the work of the staff. And there may be too many to mention, but I feel I should mention the work of Harry Jorgenson. He picked up the process when he came in to help out as our General Counsel and started putting a record together that we could act on. And that was carried on by Mark Tenhundfeld. I also want to thank John Foley, he's been extremely helpful throughout the process, and Neil Crowley, all of the Office of General Counsel, certainly Steve Cross and the Office of Supervision have done a superb job. And I also want to very much thank Scott Smith in the Office of Policy. There's many more, but it shows a staff that's really committed, hard working, and effective.

So let me just conclude by saying I think we're taking an action which strengthens the Home Loan Bank System. And I feel very confident that the action we'll take today, that people will look back in the future to this day and say the Board did the right thing for the System. Thank you.

CHAIRMAN CASTANEDA: Thank you, Director Leichter. Director Mendelowitz?

DIRECTOR MENDELOWITZ: Thank you, Madame Chair.

I always find correcting the record a really tedious chore. So I'm going to make my comments really short. So I don't have to spend a lot of time correcting the record.

First of all, I want to thank you, Madame Chair, and my colleagues on the Board for their willingness to work through the many tough issues associated with this proposed regulation. We've come a long way from where we began last September when this proposed rule was first put before us. We would never have reached this point without the leadership of our new Chair and her willingness to work with her fellow Board members and the Finance Board staff, and the SEC.

As we all know, Madame Chair, when you joined the Finance Board, the Board had neither the legal nor financial

and economic analysis necessary to provide the basis for consideration and approval of this rule. When the proposed rule was put before us in September, I spoke at length about the issues that I felt needed to be resolved before moving forward. The proposed rule was only a start, not an end. Because of the progress we have been able to make, and that only in the past couple of months, I feel that we now have a proposal that I can support.

Also, despite the many open matters, one issue that needed no discussion was the desirability and importance of the best possible disclosure. All of us on the Board and throughout the Home Loan Bank System I believe have always supported the best possible disclosures for the Federal Home Loan Bank System. There's never been any debate about that. The only question was who should administer disclosures?

Before that question could be settled to my satisfaction, we had to determine if we had the legal authority to require the Home Loan Banks to register with the SEC. Last February Director Leichter and I offered a proposal to require the Finance Board to seek an opinion from the Office of Legal Counsel on this question because we viewed it as a conflict between the statutes of two sovereign and independent regulatory agencies. As you know

a majority of the Board did not agree with us. Nevertheless, I feel we were successful when it came to the substantive issues that had to be addressed. We now have a good memo from the Office of General Counsel that addresses our concerns.

And while the conclusion is not one that can be--reaches an unchallengeable position, I believe that we do have the legal authority to require SEC registration.

On the other issues of concern, good progress has also been made. The final proposal clearly recognizes the preeminence of the Finance Board's statutory responsibility to ensure that the Home Loan Banks operate in a safe and sound manner, perform the housing finance mission, remain well-capitalized, and have access to the capital markets. Nothing we do diminishes our authorities and responsibilities with respect to these statutory charges.

Furthermore, we do not cede our authority to require more meaningful disclosures from the Home Loan Banks in addition to the GAAP disclosures that are administered by the SEC. And, of course, as I want to put on the record, the supervision of the System-wide disclosures in the form of the combined financial statements remains with the Finance Board.

As we go forward, we have also received assurances from the SEC that the unique aspects of the Federal Home Loan Bank System is a cooperative government-sponsored enterprise will be fully accommodated in the registration process. And we are relying on the SEC's representation concerning the effectiveness and permanence of the accommodations in the form of no-action letters and accounting interpretations to resolve the open issues that, of course, are critical to our progress on this matter.

I'd also like to mention that we now have a more realistic implementation date in the regulation than previously. The Banks have a full year to complete the registration process. And I think that is more than enough time. And even then if unanticipated events occur that require additional time to resolve, the rule provides that the Finance Board may extend the implementation date for good cause. And, please, don't anyone interpret that provision as inviting frivolous petitions.

So lastly, I want to thank, again, my colleagues on the Board and Madame Chair, your wonderful and collegial leadership. I want to thank the staff, both in the General Counsel's Office and the Supervision staff for their excellent support and analysis. You've turned out a prodigious amount of high quality work in an incredibly

short period of time. And we, on the Board, are very much appreciative of your efforts.

Therefore, I look forward to the vote on the regulation and providing my support for it.

CHAIRMAN CASTANEDA: Thank you, Director Mendelowitz. Thank you all.

I would like now to ask for a motion to adopt the final rule.

SECRETARY JACKSON: So moved.

CHAIRMAN CASTANEDA: Okay. I'm sorry. Secretary Jackson?

SECRETARY JACKSON: I so move for the adoption of the final rule.

CHAIRMAN CASTANEDA: Okay. We are all made – Okay. I'm sorry, Secretary Jackson. Forgive me. I guess this is a big day and I'm trying to see where we stand.

Okay. So now you have -- the Secretary will please call the roll on the motion to adopt to adopt the final rule.

MS. GOTTLIEB: On the motion before the Board, Director Leichter, how do you vote

DIRECTOR LEICHTER: Yes.

MS. GOTTLIEB: Director Mendelowitz?

DIRECTOR MENDELOWITZ: Yes.

MS. GOTTLIEB: Secretary Jackson?

SECRETARY JACKSON: Yes.

MS. GOTTLIEB: Chairman Castaneda?

CHAIRMAN CASTANEDA: Yes.

Thank you, my fellow Directors. I believe this vote serves the Nation well. And again, my thanks to the staff who had worked on this project. And I'm sure we will continue to work on SEC registration in months ahead.

Let us now take a 15 to 20 minutes break before the closed portion of the meeting. And I wanted to thank again Secretary Jackson. And I think we almost made it to your deadline, sir, if I may say so. Thank you, everybody.

[Whereupon at 11:10 a.m., the open session was adjourned and the meeting proceeded into closed session.]