FEDERAL HOUSING FINANCE BOARD

OPEN MEETING

Friday, October 29, 2004
Washington, D.C.

The Board meeting convened, pursuant to notice, at 10:05 a.m., at 1777 F Street, N.W., Second Floor Board Room, Washington, D.C.

MEMBERS PRESENT:

ALICIA R. CASTANEDA, Chairman

FRANZ S. LEICHTER, Director

JOHN C. WEICHER, Director

ALLAN I. MENDELOWITZ, Director

STAFF PRESENT:

MARY GOTTLIEB, Secretary

A G E N D A

P R O C E E D I N G S

[10:05 a.m.]

CHAIRMAN CASTANEDA: So perhaps we can start with the public vote to approve the closed portion of today's meeting, a vote required by the Government in the Sunshine Act and Finance Board regulations.

As the announced agenda states, the closed portion is a periodic update of the examination program's supervisory findings. The Sunshine Act and Finance Board regulations specifically allow closure of meetings to receive such updates. These sessions include bank examination, information that is sensitive and confidential for the closed meeting. The transcript of this portion of the meeting will contain information that may be withheld from publication under our regulations.

So at this point, I will ask for a motion to both close that portion of this meeting dealing with exam programs and supervisory findings and to seal the transcript and record of this portion of the meeting.

Director Leichter, please?

DIRECTOR LEICHTER: Thank you. Good morning.

Madam Chairman, pursuant to Finance Board Regulation Section 912.5(b), I move to close that portion of this meeting dealing with the review of Finance Board examination programs and supervisory findings and further that this Board determine, pursuant to Finance Board

Regulation Section 912.5(c)(3) that the record and transcripts of this closed portion of the meeting shall be kept confidential pursuant to Finance Board Regulation Section 912.4(a)(8).

CHAIRMAN CASTANEDA: Thank you for the motion, Director Leichter.

Is there any discussion of the motion?

[No response.]

CHAIRMAN CASTANEDA: Any discussion of the motion?

[No response.]

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

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: Director Weicher?

DIRECTOR WEICHER: Aye.

MS. GOTTLIEB: Chairman Castaneda?

CHAIRMAN CASTANEDA: Yes.

The motion is carried, and the subsequent portion of our meeting will be closed, and the transcript therefore will remain closed and confidential. Thank you.

Let us now turn to the public portion of today's meeting. The first item on the agenda is a proposed resolution from Directors Leichter and Mendelowitz regarding the appointment of directors to Federal Home Loan Banks.

Director Leichter, I believe you're going to start the discussion.

DIRECTOR LEICHTER: Yes; thank you, Madam Chairman.

Director Mendelowitz and I have brought this resolution before the Board because we think it's extremely important that we have a process in place by which this Board will select public interest directors. The aim of this resolution is to have a process which is open, transparent,
need-based and depoliticized. I don't know whether it's really necessary to spend much time to give the reasons for having a process.

Certainly, one of the important functions of the Finance Board is to choose public interest directors for the boards of directors of the banks. This Board has made a real emphasis of the importance of good governance, and good governance by the banks obviously requires that you have a well-qualified board of directors for the Federal Home Loan Banks. And this means that the public interest directors have to be chosen for their qualifications, their ability, their experience, their ability to contribute.

I, during my period of service on the Board, have not seen as much concern within the system about the appointment of public interest directors as I've seen this year. I think it's something that's really been growing, and I think it reflects the dissatisfaction, frankly, within the system of the job that this Board has done in selecting public interest directors.

Now, this is not just anecdotal. It's not just hearsay. It's actually something that has been confirmed by the governance audit done by our own Office of Supervision, and that audit shows that the banks stated that they needed to have good, qualified public interest directors and were dissatisfied with the manner in which the public interest directors had been selected by the Finance Board.

It was, I think, earlier this year that we had public hearings on governance, and we heard from many representatives of the banks, good people who understand the system and who pointed out what the needs of their banks were to have qualified public interest directors and public interest directors that have some continuity.

Unfortunately, particularly one year, this Board pursued a policy of not reappointing people to the boards of directors of the banks, and this created, in many of the banks, boards where there was really no continuity, no experience, no institutional memory, and it made the governance of the banks all that much more difficult. So I think we need to have a process, and if you don't have a process, if you don't have a good process, it's quite likely that the end product will be flawed and not as good as it should be.

Let me say, Madam Chairman, this proposal of Director Mendelowitz and I is not presented in a contentious manner, as you know. We've discussed it over some period of time, and we've had fruitful discussions with you, and I want to say, and I think it's obvious to everybody that this Board is working very harmoniously, collegially; that some of the difficulties that we've had in the past I think have disappeared, and I don't want anybody to get the wrong impression that this indicates a partisan division in the Board over the public interest directors. I very much hope that that's not the case.

The reason that we're presenting the resolution at this time is that we've really run out of time. We need to make our public interest director selection by the end of the year. We're now almost into November. If we don't put a process in place now, we're not going to have a process in place for doing the public interest directors as they should be done by the end of the year.

So our hope is that even if this resolution will not be adopted, and obviously, we haven't come to agreement, that we will continue to work together and that we will have an open process and that everybody in the system will know this is the process that the Finance Board is following; that it's a fair process and that it's an open process and a process that will lead us to choosing the best possible public interest directors that we can for the boards.

The process is not a very complicated one, and I frankly think it's one that would serve us well. Let me just briefly review it. First of all, the process that we've set forth provides that the qualifications that we're looking for in public interest directors be publicly known and be accepted and followed by this Board, and I want to say, Madam Chairman, that some of the qualifications that we have put in this resolution are really based on discussions that we've had, and your input has been very helpful on this.

And what we provide is that the appointed directors in each Federal Home Loan Bank as a group should be diverse by geography, ethnicity, race and gender and possess a good combination of the following skills: affordable housing expertise, community economic development expertise, housing finance expertise, financial services expertise, financial risk management expertise, capital market expertise, accounting expertise, and understanding of the mission, purpose and operation of the Federal Home Loan Bank system.

What our process also does is to involve the banks of the system more in the process that we would ask them to identify the needs that the banks have. Those needs may differ from bank to bank. We should know what it is that a bank is looking for in the desired qualifications to guide us as we make our selection.

We should also involve our Office of Supervision and based on their examination and their knowledge of the banks to have their input of what the Office of Supervision feels would be helpful and even needed for the public interest directors of the banks. We would have a 30-day notification period of nominations, and we would put this in the Federal Register, and we would solicit nominations from as wide a universe of interested people as possible.

The process also says that the selection is to be done timely, should be done by the end of the year, so that as the new year starts, the banks will have a full complement of directors. The selection should be done by this Board in an open meeting and that the information as to who recommended the appointees that are being put forward for selection be publicly available.

So as you can see, I think it's a fairly simple, fairly straightforward, and I must say, I don't think a process that should create difficulties or problems for anyone.

I want to say one other thing, I think, that's important and that ties into the responsibility that we have on this Board: and I've already talked about the importance of doing this in a timely fashion, and this points up the fact that there are presently vacancies of public interest directors on the boards of some of the banks.

One vacancy, at the New York Bank, has existed since January. That bank, the New York bank, has another vacancy that's existed since June. San Francisco has a vacancy. Recently, its president, Dean Schultz, wrote us to point that out. I think we erode our own credibility when we talk to the banks about governance, when we fail to do our job in giving them the necessary complement of directors. It really erodes our own credibility, and I hope--you and I have discussed this, Madam Chairman--we should not have these vacancies exist for, as I pointed out in the case of New York, for the entire year without acting on it.

I think that raises questions in people's minds how serious we are about governance. I know we want to be serious about it, but I think it's our obligation to really act on it. So the election of public interest directors has been, unfortunately, contentious. It shouldn't be. I think if we have this sort of an open process which seeks to get the very best people to meet the needs of the banks, and we do this in an open, transparent manner, that we will create much greater competence in the system of the work that we do and we will be able to provide, I think, well-qualified, able people for the boards of directors of the banks at a time when the banks have greater and greater responsibility, and the position of a board member has become more and more important and sensitive.

So even if we're not able to adopt this process at this time, let's work together; let's have a process. I think it's the right thing to do.

Thank you.

CHAIRMAN CASTANEDA: Thank you, Director Leichter.

Director Mendelowitz?

DIRECTOR MENDELOWITZ: Thank you.

CHAIRMAN CASTANEDA: Do you have any comments, remarks?

DIRECTOR MENDELOWITZ: Thank you, Madam Chair.

I want to thank you for placing this item on our agenda today. I think it's both timely and important that we have this discussion. Our governing statute gives the Finance Board the responsibility for appointing public interest directors to the boards of the 12 Federal Home Loan Banks. These boards of directors are the first line of defense in the corporate governance of their institutions and through that, the first line of defense in assuring the safety and soundness and mission accomplishment of the banks for which they're responsible.

This is a serious responsibility and probably the most important action that we can take to strengthen the quality of corporate governance at each Federal Home Loan Bank. Over the past couple of years, the Finance Board has taken an extra hard look at the corporate governance structure of the Federal Home Loan Banks.

In June of 2003, the Office of Supervision conducted a systemwide review of corporate governance practices throughout the Federal Home Loan Bank system. This staff report raised concerns, echoed throughout the system, that the public interest director appointment process needed to be examined. To follow up on this report, the Finance Board held a hearing on the subject earlier this year.

During this hearing, we heard testimony from a number of witnesses describing a confused and unknown process for selecting public interest directors. Today, Director Leichter and I are offering a resolution that would create a process by which we can better select public interest directors. In a nutshell, this proposal would outline the necessary skills that each board should, as a whole, possess.

We would then solicit input from each of the Federal Home Loan Banks as to the skills that would be needed on each of the boards. The Finance Board, through the examination process, would also provide our own assessment of the skill needs of each of the Federal Home Loan Bank boards. Under this proposal, we would publish a notice in the Federal Register requesting nominations to the boards of directors of each of the Federal Home Loan Banks, and then, finally, the Finance Board would meet to consider and vote on the nominations. The source of these nominations would then be available to the public on request.

Simply put, the goal of this proposal is to assure that the selection of public interest directors is the result of a needs-based, transparent process of the Federal Housing Finance Board. As I said, Director Leichter and I are the sponsors and authors of this proposal, but it is my wish that this become a board proposal.

I know that we do not have a majority of votes today. However, neither is there a majority of votes against the proposal. So I would like for us to view this as a positive start of an effort to further develop the proposal, and in that spirit, I hope to receive comments from interested parties on the proposed resolution and look to improvement of the design and structure of the proposal as we go forward.

Madam Chair, we have had some very good meetings on this issue, and I hope to continue the dialogue. It is not an easy issue to resolve; we all know that, but one that I think we can resolve over time through hard work and cooperative efforts.

Thank you.

CHAIRMAN CASTANEDA: Thank you, Director Mendelowitz.

Director Weicher, do you have any comments?

DIRECTOR WEICHER: Yes, thank you, Madam Chair. However, I have to sit forward to be properly heard.

CHAIRMAN CASTANEDA: You're doing just fine.

DIRECTOR WEICHER: Thank you. So far so good.

I think that the concerns that have been raised by my colleagues as they have introduced and spoken to this resolution, many of these concerns are legitimate concerns, and I take Director Leichter at his word in saying that this is not a partisan proposal, and I intend to try to respond to it in the same spirit that you offer it and support it.

I think that we have a--we have all had discussions about the process that we have had in the past three years. I have some previous experience as a member of the Federal Savings and Loan Advisory Council, back when there were only three members, and this was the Federal Home Loan Bank Board and served and met with a number of individuals who were elected to that advisory council by the members of the Home Loan Banks, many of whom were already directors of the individual Home Loan Banks.

And I know from that experience that it is difficult to find people who have all the skills that you want to be the regulators and in that case the advisors to the regulators on the individual banks and, in that case, also on the system. My own thinking is this: we have a new chairman this year, as we know, and I think we know also that we have a chairman who is--who takes seriously our concerns and who has talked to all of us individually about the--about her views on the issues that we have dealt with over this past eight months or so.

As we all also know, the President has nominated a new director for our vacancy, my colleague now and in the administration of the first President Bush also my colleague, the current president of the Government National Mortgage Association, Ronny Rosenfeld.

My own thinking is that this resolution at this point is, I think, premature. I would suggest that we let our chairman work through this process in her first year, as I'm sure we all remember, our chairman came on the board as a member. I think your first meeting, Madam Chair, was the meeting in which we appointed the directors for this year early in '04.

My suggestion is that we allow our chairman to work through the process this year seeking our advice and that at that point, we see if there is a formal procedure that we want to put into place which will enable us to move forward perhaps along the lines of Director Leichter's proposal, perhaps along other lines that the Chairman finds useful as we go through the process this year.

So I would suggest that this is a resolution that is not, I think, from my standpoint, really desirable at this point.

CHAIRMAN CASTANEDA: Thank you, Director Leichter, Mendelowitz and Weicher, again, for your comments and remarks.

I believe that we all agree that corporate governance at the Federal Home Loan Banks and the role of public interest directors are important issues. I certainly feel very strongly about them. Your proposals, Director Mendelowitz and Director Leichter, are thought-provoking and merit full consideration.

But as you and I we have discussed it many times, this is my first time through the full appointment process from start to finish. And I really believe I feel we need some more time to study the issue. But the process has been in the past what has worked but needs to be--hasn't worked, what needs to be changed before reaching a decision about whether we should formally change the process and, if so, how.

So while I appreciate your perspectives, and I am not prepared to move forward as you have outlined it, and I cannot support your proposal.

At this time, I would ask for a motion to adopt the resolution.

DIRECTOR LEICHTER: I move the adoption of the resolution.

CHAIRMAN CASTANEDA: Okay; Mary, would you like to call on the resolution?

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: Director Weicher?

DIRECTOR WEICHER: No.

MS. GOTTLIEB: Chairman Castaneda?

CHAIRMAN CASTANEDA: No.

Thank you. Now, let's move to the next item on our public--

DIRECTOR LEICHTER: I guess you should announce that the resolution is not adopted.

CHAIRMAN CASTANEDA: Okay.

Mark, get me out of this. The resolution has not been--

MR. TENHUNDFELD: It is the observation of the general counsel that the resolution did not pass.

DIRECTOR MENDELOWITZ: But the resolution was neither defeated.

[Laughter.]

CHAIRMAN CASTANEDA: Director Leichter, I'm delighted that you're here to put me in place.

Now, let's move to the next item on our public agenda, a resolution to appoint two members of the Financing Corporation Directorate--we formally refer to it as FICO--

for a one-year term of office starting November 10, 2004. And we are delighted to have here Pat Sweeney, who is going to be telling us about this new proposal.

MS. SWEENEY: Thank you, Madam Chairman.

The Financing Corporation, FICO, is a relic from the 1980s thrift crisis, chartered by the former Federal Home Loan Bank Board under the Federal Savings and Loan Insurance Corporation FSLIC, Capitalization Act of 1987.

It is a mixed-bag, tax-exempt Government corporation owned by the Federal Home Loan Banks, the principal purpose of which is to serve as a financing vehicle for the former FSLIC Resolution Fund. FICO services the debt on bonds that were issued prior to 1989 to fund the savings and loan bailout. The annual interest payments on such bonds total approximately $793 million.

The Financial Institutions Reform, Recovery and Enforcement Act, that is, FIRREA, authorized FICO to assess members of the Savings and Loan Association Fund, SAF, to fund its obligations. Post-FIRREA, FICO is subject to the general oversight and direction of the Federal Housing Finance Board. Its operations are under the management of a three-member board designated as the FICO Directorate, which is appointed by our Board of Directors as composed of three members that consist of the managing director of the Office of Finance and two members who are selected from among the 12 bank presidents.

According to statute, each bank president is appointed for a one-year term, and no bank president may be appointed for an additional term until each of the other banks has served as many terms on the FICO Directorate as the president of such bank.

Under an informal agreement between the bank presidents and the former Federal Home Loan Bank Board reached in 1987, the sequence of appointments was initially based on seniority of bank presidents. The bank president selection process for the FICO directorate appointments now is in its third rotation cycle. The initial cycle was completed in 1993. Upon completion of the first rotation cycle, the Finance Board established a second cycle, initially given priority consideration to the appointment of those individuals who had not yet served on FICO.

While seniority continued to be a guiding priority, the rotation cycle was adjusted to avoid overlapping appointments with the Resolution Funding Corporation Directorate. This second rotation cycle was completed in November of 1999, and the charts in your books show you the exact rotation cycles for these two that have been completed.

We are currently now at the end of the third rotation cycle, as shown on page 3 of your board package. Eight banks have completed the representation on FICO; two banks are about to complete this representation as of

November 9, 2004. Those two banks are Topeka and Des Moines. With that, only two banks remain outstanding in the cycle, San Francisco and Pittsburgh.

Accordingly, staff recommends the appointment to the FICO Directorate of Dean Schultz and James D. Roy, whose banks are the two remaining in this third rotation cycle. This recommendation has been made in compliance with the statutory requirement that no other banks serve until all have been equally represented. A resolution has been prepared for your review and approval by the Finance Board to appoint Dean Schultz and James D. Roy to serve on the FICO Directorate for a term of office starting November 10, 2004.

CHAIRMAN CASTANEDA: Thank you, Pat. Thank you very much.

Is there any discussion from the Board?

[No response.]

CHAIRMAN CASTANEDA: Then, I would accept a motion to approve the resolution.

DIRECTOR WEICHER: So moved.

CHAIRMAN CASTANEDA: Would the Secretary please call the roll?

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: Director Weicher?

DIRECTOR WEICHER: Aye.

MS. GOTTLIEB: Chairman Castaneda?

CHAIRMAN CASTANEDA: Yes.

The motion is adopted. Thank you.

Before we enter into our closed--

DIRECTOR WEICHER: Madam Chair?

CHAIRMAN CASTANEDA: I'm sorry?

DIRECTOR WEICHER: Excuse me; may I ask a--this is not directly related to the resolution, but may I ask a question on this general subject?

CHAIRMAN CASTANEDA: Oh, absolutely, Director Weicher.

DIRECTOR WEICHER: We didn't talk about this earlier, but looking--I haven't talked about this with any of my colleagues, but as we're coming to the end of the third rotation, presumably, we're going to have to develop a policy for the fourth rotation.

I notice that I believe 11 of the 12 current presidents have sat during--have served on this during the third rotation.

MS. SWEENEY: That's right.

DIRECTOR WEICHER: Which raises the question of whether we would--it would be our pleasure to try to repeat the same cycle or nearly the same cycle. As best I can judge, we haven't been too precise in keeping the people in the same pattern that was established with the first cycle.

MS. SWEENEY: Right.

DIRECTOR WEICHER: Apparently at least because there has been some turnover in the presidents over the 18 years.

MS. SWEENEY: Right; it actually, is based though, on banks. So regardless of whether there's been turnover, it's the actual bank representation, not the face representation. The first cycle was very much based on seniority. In the second cycle, as I mentioned, we looked at individuals who had not served at all and then started to change the rotation cycle and also took into consideration not wanting to conflict with the Resolution Trust, with REFCORP appointments. We made every attempt to do that.

It would seem to be a good way to go if we were to continue in this established cycle. I think it would be good, because it's published; it's out there; there's record, and we can anticipate, then, and also, then, be able to make measured decisions on a suggestion for the REFCORP appointment.

CHAIRMAN CASTANEDA: So the answer is yes.

MS. SWEENEY: Yes.

DIRECTOR WEICHER: I note that we've had for all of these reasons, we've wound up with some banks being represented two years closely together, such as at the beginning of the cycle, Seattle and Atlanta were both in the fifth year of the second cycle and in the first year of the third cycle, whereas Des Moines went from the second year of the second cycle to the fifth year of the third cycle, and similarly, San Francisco has gone nine years between the second and third, and Cincinnati went from the first year of the first cycle to the last year of the second cycle.

Now, with all of the constraints, I'm sure something along this line is unavoidable, but it would be useful to try to see what kind of cycle fits at this point.

MS. SWEENEY: Right, and we'll also be at the beginning of the REFCORP cycle, so it's actually a clean slate. There are no constraints facing us right now, so we could propose a cycle and adhere to it as much as possible, understanding that we would attempt to avoid any conflicts with overlapping appointments.

DIRECTOR WEICHER: It just occurs to me looking through this--

CHAIRMAN CASTANEDA: Good point.

DIRECTOR WEICHER: --that something along that line might be useful.

CHAIRMAN CASTANEDA: Good point.

Okay; any other comments?

[No response.]

CHAIRMAN CASTANEDA: Okay; will the Secretary please call the roll?

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: Director Weicher?

DIRECTOR WEICHER: Yes.

MS. GOTTLIEB: Chairman Castaneda?

CHAIRMAN CASTANEDA: Yes.

The motion is adopted.

Before we enter into our closed meeting, I do want to mention a new advisory bulletin that is being issued to the Federal Home Loan Banks today. This advisory bulletin addresses several questions that have arisen regarding the registration by the Federal Home Loan Banks of a class of their equity securities under the Securities Exchange Act of 1934.

As we all know, in June of this year, the Finance Board adopted a resolution requiring the banks to file a registration statement by June 30, 2005, and for SEC registration to be effective no later than August 29, 2005. Discussing their progress toward registration, several of the banks posed questions about specific issues, and we thought it appropriate to address these issues through an advisory bulletin.

Most of this bulletin is in a question and answer format, and I am confident the information will be helpful to the banks as well as their members who are following the registration process. Again, we will be distributing this bulletin to the banks later today.

Thank you all for coming today, and this ends the open session of the meeting. We will convene in closed session in a few minutes. But, one minute, before we break, I have a short presentation, one that is sad for the Finance Board and certainly for myself but one that also gives us, all of us, the honor of extending our best wishes to a colleague and friend as she undertakes a new professional challenge.

Today is Mary Gottlieb's last day at the Federal Housing Finance Board, where she has served in the Office of General Counsel with great diligence and dedication. Mary will be moving over to the OCC, where we all know she will continue to do a great job. The directors have all signed a certificate of appreciation, which I would like to present to Mary, and Mary, thank you so much and congratulations on your new position.

We wish you all the best, and I know you're going to be--will do great, but I'm going to miss you a lot. So I would like to present this on behalf of everybody, actually, at the Finance Board.

MS. GOTTLIEB: Thank you. Thank you, everyone.

[Applause.]

CHAIRMAN CASTANEDA: Okay; why don't we take 10 minutes' break before we return for the closed portion of the meeting?

[Whereupon, at 10:42 a.m., the open meeting recessed, to reconvene in closed session at 10:55 a.m., this same day.]