FEDERAL HOUSING FINANCE BOARD

PUBLIC HEARING

BOARD GOVERNANCE OF THE FEDERAL HOME LOAN BANKS

Friday, January 23, 2004

10:00 A.M.

Federal Housing Finance Board
1777 F Street, N.W.
Board Room (2nd Floor)
Washington, DC 20006

BEFORE:

JOHN T. KORSMO, Chairman
FRANZ S. LEICHTER, Director
ALICIA CASTANEDA, Director
JOHN C. WEICHER, Director
ALLAN I. MENDELOWITZ, Director

TESTIMONY

PANEL 1

DAVID LEDFORD
National Association of Home Builders

CAROL WAYMAN
National Congress for
Community Economic Development

ROBERT D. BROEKSMIT
Mortgage Bankers Association

PANEL 2

J. EDWARD NORRIS, III
America's Community Bankers

DAVID HAYES
Independent Community Bankers of America

P R O C E E D I N G S

CHAIRMAN KORSMO: I call this hearing of the Federal Housing Finance Board to order. I appreciate my colleagues being here. As unfortunately happens on occasion, Commissioner Weicher is otherwise disposed. I'm hoping he will be joining us a little later. He called with his apologies. He has read the testimony, and he appreciates -- he wanted me to convey his appreciation to all of the speakers here today for your participation in which I'm certain he joins all of us. To all here who are going to speak today and to all who submitted written testimony, thank you.

This hearing has prompted a great deal of interest, so much so that we will hold a follow-up hearing on Tuesday, February 10th, to receive further testimony. The response, I believe, demonstrates the widespread appreciation of the importance of board governance of the Federal Home Loan Banks -- these very large financial institutions that play a critical role in our nation's system of housing finance.

Certainly, I have made the best corporate governance -- made best corporate governance a focus of mine as Chairman of the Federal Housing Finance Board, a goal I know all of my colleagues have consistently shared. Last year, as many of you know, the Office of Supervision completed a horizontal review of corporate governance practices at the Federal Home Loan Banks, an assessment that today's hearing builds upon. In addition, I have had many productive conversations on governance topics with directors and executives of the Banks, and I appreciate their insights.

The purpose of today's hearing and next month's session is to collect suggestions and information about possible changes to Finance Board regulations or to the Federal Home Loan Bank Act, changes that would serve to help the Boards of Directors of the Banks to better identify, measure, monitor, and control the risks on the balance sheets of the twelve Banks. The basic structure and prerogatives of a Federal Home Loan Bank Board of Directors are little changed from the template Congress enacted in 1932, but the financial world looks profoundly different than it did more than seven decades ago.

Now, with the demands placed on Boards by the evolution of these dozen cooperatives and the major financial services providers with global reach by the requirements and standards set by Sarbanes-Oxley and by the obligations associated with SEC registration, it is timely to ask directors of the twelve Federal Home Loan Banks, the

Banks' members, and other stakeholders whether there is room for constructive change.

Another profound, but less tangible change, is also under way. Gramm-Leach-Bliley devolved into the hands of each Board full authority and responsibility for charting the business course of its respective Bank and the duty of prudent management. Gramm-Leach-Bliley also completed the evolution of the Federal Housing Finance Board into an arm’s-length safety and soundness regulator.

To fulfill these statutory mandates, my colleagues and I have instituted steps that are thoroughly changing the way we oversee the twelve Federal Home Loan Banks and the Office of Finance. The regulator no longer participates in operating Banks. The regulator no longer dictates how to operate Banks. The regulator no longer serves as an advocate or buffer for Banks in public policy debate. Instead, the Finance Board now examines and supervises to determine whether the choices made by each Board of Directors are informed and effective choices.

To those of you who are executives of a commercial bank, a thrift, or a credit union, this is the familiar relationship for federal banking regulators to the institutions you manage. But in the experience of Federal Home Loan Banks, this is a change. Becoming accustomed to this arm’s-length relationship is a challenge. But this much is clear so far. With the regulator no longer figuratively in the board room signing off on each decision, the capabilities and practices of each Federal Home Loan Bank Board deserve a fresh look.

My colleagues and I are not asking any witness to endorse or critique a proposal. Indeed, no proposal is before us. We only ask for your best, most candid thoughts based on actual experience. With Congress set to resume work on possible ways to improve regulation of the housing GSEs, it is also appropriate that the Finance Board be ready to identify what, if any, other changes to statute or regulations may better equip directors to fulfill their obligation to be the ultimate authority at each Federal Home Loan Bank, and their responsibilities to represent the first line of defense for the taxpayers.

The witness list for today and for next month's session represents a broad cross-section of both members and directors of Federal Home Loan Banks and others with important voices in financial and housing policy in this nation. We're eager to hear from the Boards of all the Banks, but we, by no means, seek a consensus. There will be time for building consensus when and if a proposal is developed.

What we do seek is a variety of views, experiences and suggestions. Increasingly, the makeup of both the membership and the balance sheets of the twelve Banks is marked by great variety. No longer can one presume that all the Banks share the same experiences. Speaking for myself, I also look forward to hearing whether there are still sound reasons to govern a 300-member Federal Home Loan Bank the same way a 1,000-member Bank is governed, whether a $50 billion Bank should have the same Board composition as one twice that size, and whether a cooperative focused on building and prudently managing a large mortgage portfolio is best served by Board Governance practices developed to manage a portfolio of advances only.

As I mentioned earlier, the interest in this hearing is high. We have five people with us to testify in person, representing their respective trade associations. Before I call on my colleagues to present any opening comments they may have, let me once again welcome our panelists and describe the process for us today.

We'll have three people on our first panel, two who represent organizations -- while they don't represent members of the Banks -- have a profound interest in the responsibilities and the mission of the Banks -- David Ledford, who is Staff Vice President of the Federal

Regulatory and Regulatory, excuse me, Staff Vice President -- let me get this right Dave -- of Federal Regulatory and Housing Policy of the National Association of Homebuilders. Also with us is Carol Wayman, who is Director of Policy for the National Congress for Community Economic Development, and also we -- a member from a -- a representative of a member organization, whose schedule required we put him on the first panel rather than on the second. If there was any confusion as to what your role was, Bob, I apologize for that, but we're also glad to hear today from Robert D. Broeksmit, President & CEO of B.F. Saul Mortgage Company, who will be representing the Mortgage Bankers Association.

On our second panel, we will hear from J. Edward Norris, III, Chairman, President & CEO of Plantation Federal Bank. Mr. Norris is today representing America's Community Bankers, and speaking on behalf of the Independent Community Bankers of America is David Hayes, President & CEO of Security Bank of Dyersburg, Tennessee.

We've also received written testimony from the Federal Home Loan Bank of Des Moines, the Federal Home Loan Bank of Boston, the National Association of Realtors, the Credit Union National Association, and the American Bankers Association. And if there is no objection, we will include these written comments in the record of this hearing.

To everyone participating, you have my thanks for taking the time to collect your thoughts and offer them at this public forum today. Before we proceed to the panels, again, let me ask if any of my colleagues on the Finance Board would like to make any opening statements? Alicia Castaneda?

DIRECTOR CASTANEDA: I would like to thank all of the speakers that have come to see us today. Today is my first open hearing, and I cannot think of a better topic than the Board Governance to hear. Thank you, all of you.

CHAIRMAN KORSMO: Director Mendelowitz?

DIRECTOR MENDELOWITZ: Thank you, Mr. Chairman.

I believe that this hearing is extremely important and timely. The issue of improving corporate governance should be one of the highest priority for the Finance Board, and one that we take very seriously as a Board. I look forward to hearing from our witnesses today. However, let me first make a few comments and observations.

After I arrived at the Finance Board and had the opportunity to travel around the system and learn first-hand about its strengths and weaknesses, I called for a system-wide review of corporate governance with the goal of identifying both weaknesses and best practices. It was my hope that this information would help the Finance Board improve the Home Loan Banks' Boards of Directors effectiveness in fulfilling their responsibilities.

That review was undertaken last year, and I want to commend Steve Cross and his staff on the excellent work they performed on the horizontal review of corporate governance. I think it is a great start to the discussion. The supervision staff discovered many of the same things I did in my travels around the system. Some of the Home Loan Banks have Boards of Directors that are either not as engaged or as educated as they should be. What we learn from this is that world-class corporate governance requires both best practices and highly-qualified and experienced directors.

It is my hope that with this hearing and the one scheduled on February 10th, we can further add to our base of knowledge and sound ideas on how to improve corporate governance and start the process of making some real constructive changes. Let me also say that our corporate governance report raises some interesting and important issues regarding the Home Loan Banks Public Interest Directors. I look forward to hearing from our witnesses on this important topic.

This is especially valuable because we as a Board have the responsibility and the authority to appoint these directors. It behooves us as a Board to seek out constructive criticism when appropriate and try to better the process. For too long, this process has been the subject of politics and the positions treated merely as honorifics. It is past the time that we should move to modernize and reform this process.

I'll have more to say on this subject when we convene our Board meeting this afternoon to consider the 2004 Class of Public Interest Directors. Depending upon what we hear this morning, maybe I'll have much more to say. In any event, the Public Interest Directors are just one of the topics we will touch on here. I really want to express my appreciation to all the witnesses for the time and effort they put in, the willingness to contribute to our efforts to try to understand how to improve the system, and contribute to developing world-class corporate governance in the system, and I look forward to the opportunity to discuss the full range of issues that need to be raised and addressed. Thank you.

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

DIRECTOR LEICHTER: Thank you.

I'm very much looking forward to this hearing because as we've all said and I think, as we all agree, corporate governance is of such importance, but corporate governance must be more than a buzzword. It requires adherence to real standards of good corporate management, not just splashy events which obscure and may seek to hide bad corporate practices. I'm particularly interested in the views of witnesses on two issues. One is the qualification of members of the Board of Directors of the Federal Home Loan Banks who serve as public interest directors. What is the importance of continuity in the service on these Boards? Do the Boards benefit by rapid turnover or do they benefit more by having people with experience serving on these Boards and who continue their service.

Secondly, I'm interested in how Boards should perform and act. Should they perform collegially, should there be communications among the members of the Board, should there be involvement of all the Board members, should the Chairman inform Board members of events that are going on in the Board? What is the role of communication within Boards as part of good governance.

What makes this hearing so timely is that later today, the Finance Board is going to be tested. We're going to have a test -- whether we heard what you have said to us because we are having a Board meeting at which we are going to choose Public Interest Directors. Now, there's nothing that we do -- that the Finance Board does on corporate governance that is more important than choosing Public Interest Directors because these are the directors who work on the Home Loan Banks and who have the responsibility of helping to manage these very complex, sophisticated financial institutions. And I think we will see whether we heard what you said, whether we listened to our own corporate governance audit, or whether we're disregarding good governance.

The question really is going to be whether this hearing is a dog and pony show or whether it has real meaning in guiding this Board to good corporate governance. It's not only good corporate governance for the various Banks within the system, it's good governance for this Board which is also an issue. So we'll see during the course of the day how meaningful this hearing is. Thank you very much to the three of you and to the other participants, and I'm very interested in hearing your views, particularly on those questions that I raised.

CHAIRMAN KORSMO: Thank you, Director Leichter.

With that we'll turn to our first panel. Dave, we've put you at the top of the list. I'm not sure how. It wasn't alphabetical, but David Ledford, who is here representing the National Association of Home Builders, David.

MR. LEDFORD: Thank you, Chairman Korsmo. And to all the members of the Finance Board, I really appreciate the opportunity to be here representing the 215,000 members of the National Association of Home Builders. As Director Leichter just pointed out, this is a very timely hearing and we're really looking forward to the additional dialogue that will occur at the next hearing that involves the Federal Home Loan Banks.

Earlier this week, we submitted a formal statement for the record, and today, I'll just try to summarize some of the key points from that statement. NAHB strongly supports the Federal Home Loan Banks as crucial players in the Housing Finance system, and we're extremely interested in seeing that these organizations operate in an effective and also a safe and sound manner.

The Federal Home Loan Banks are particularly important to the home building industry. The overwhelming majority of our members are small companies that don't have access to the capital markets directly and have to rely almost exclusively on depository institutions that are, in many cases, members of the Federal Home Loan Banks and rely on those Banks for liquidity support. And our builders rely almost exclusively on those institutions for the money to develop land and to build homes.

I'll try to cover four areas today -- the makeup of the Federal Home Loan Bank Boards of Directors, Federal Home Loan Bank financial disclosure, collateral for Federal Home Loan Bank, financing for the Federal Home Loan Bank products and programs.

On the issue of the Federal Home Loan Bank Boards, we share the widely-held view that it is critical -- of critical importance for members of these Boards to have both a strong grounding in housing and housing finance issues and increasingly, it's important to have extensive knowledge and expertise that is needed to evaluate and oversee increasingly complex financial operations. With that regard, we also feel that the Board should have a diverse background and so not everyone is going to have that training and expertise coming in, but it should occur and develop. And I agree with Director Leichter that continuity is extremely important and several terms on the Board, I think, does build up that experience and improve the oversight of the operations.

Now, earlier this year, the Finance Board suggested requiring one Federal Home Loan Bank Board member to have knowledge and experience in complex financial transactions, such as derivatives. Now, NAHB believes it would be preferable for all Board members to have that capacity to oversee the financial aspects of the Federal Home Loan Banks' operations, and we're concerned that allotting one Board seat to a financing or financial guru could really leave the other Board members to rely too heavily on that individual and really defer to that person for tough decisions when really the whole Board should take responsibility and accountability for those decisions.

We've also submitted comments on Federal Home Loan Bank financial disclosure and in those comments, which we just submitted a little more than a week ago, we noted that we do support enhancements to financial disclosures but we’re -- and feel they can contribute to increasing the public's confidence in the Federal Home Loan Banks, but we're also concerned that such changes could impose costs that would feed through adversely to the price credit provided by the system.

So we really feel that a thorough and in-depth analysis is needed to accurately assess the merits and costs of disclosure changes, and we urge the Finance Board to undertake a comprehensive review of changes in disclosure, and we also urge the Finance Board to publish the results of this study and provide an opportunity for public comment before initiating any further rulemaking proceedings on disclosure.

On advance collateral, NAHB believes that the Federal Home Loan Banks and their members are really missing a tremendous opportunity in not utilizing housing production loans as security for member borrowings. Even though these loans qualify as eligible collateral, they're seldom used as such. We've obtained data on acquisition development and construction financing that we provided previously to the Finance Board, and we've also submitted that with our written statement that we sent over earlier this week.

That -- those numbers and statistics and charts really show that AD&C loans have performed exceptionally well historically, and it's really notable that the loss experienced on single family construction loans is really not very different from the very low rate on home mortgages. In addition to the good performance of these loans, we think they are a strong mission-related asset and should be utilized more -- much more than they are now, and we therefore, request the Finance Board to specifically authorize the Banks to use AD&C loans -- residential AD&C loans -- as collateral for member advances and to exempt these loans from the new business activity notice procedures.

Finally, on Federal Home Loan Bank products and programs, NAHB believes it is essential for the Boards and management of the Federal Home Loan Banks to have a great deal of flexibility within the bounds of safety and soundness to undertake activities that address unique housing needs in the different districts and they are quite different from one part of the country to another.

We really commend the Finance Board for ongoing efforts to provide such autonomy for the Federal Home Loan Banks with regard to the affordable housing program. We think tremendous improvements have occurred over the years and the rules of the program allowing the Federal Home Loan Banks to really take initiatives that are unique to their area.

NAHB has been a strong proponent also of the development of new programs beyond the affordable housing program and again express our appreciation to the Finance Board for encouraging the Federal Home Loan Banks to develop innovative responses to housing finance needs in their districts. And we still believe there are many more opportunities that haven't been explored. For example, there appear to be significant opportunities in the housing production area, construction loans and development loans, and we also believe that the area of multi-family financing is one that has tremendous unmet financing needs, particularly in rural areas, and those should be addressed by the Federal Home Loan Banks as well.

In conclusion, NAHB and its members are standing ready and willing to work with the Board and the Federal Home Loan Banks and the system's members to identify and address challenges and opportunities in housing finance.

Thank you for this opportunity.

CHAIRMAN KORSMO: Thank you, David. I neglected to mention the procedural point. Unless there is an objection, I think what we will do is hear the testimony of all three members of the panel and then we'll open the floor for questions for any or all of the panelists.

So with that, let me turn to Carol Wayman. Carol is the Director of Policy for the National Congress for Community Economic Development. Carol, thank you for being here today.

MS. WAYMAN: Good morning, Mr. Chairman and members of the Finance Board.

I represent the National Congress for Community Economic Development, which for more than 30 years has represented the nation's non-profit community-based organizations that work to create jobs, build homes, and provide economic opportunities in distressed urban, rural and inner ring suburban communities around the country, and we have 700 member organizations, many of whom work in African-American, Latino, Asian-Pacific American, and Native American communities. And because of our finance work on our economic development and affordable housing work, the Federal Home Loan Bank is a critical partner for every aspect of the activities of the nation's 3600 community development corporations. And we really appreciate the opportunity to share our views on how changes to the Federal Housing Finance Board regulations of the Federal Home Loan Bank Act can enhance corporate governance.

And I'm also going, like my colleague, to condense my written remarks with some of our key points related to mission, measurement, and monitoring. We believe that if you ask the Board of Directors of the twelve Federal Home Loan Banks or the regulators, Congress was asked by the media or the public why the Federal Home Loan Bank system exists, they would note that the Bank has 8,000 financial institutions, and they provide long-term patient capital that meet the need for financial investments. And that liquidity provides money for housing, multi-family, single family, economic development, community facilities to cities, towns, rural areas, and multi-county regions. So meeting this need is the mission of the system.

And so the mission should be in any discussion -- it should be at the forefront -- of any discussion of corporate governance. But with measurement, how do we know how the system measures up in meeting the mission of the system. Fannie Mae and Freddie Mac have very clear housing goals. OMB is doing a performance assessment rating tool for every federal program to see how it meets the needs of low-income people -- if that's the goal of the program -- the communities and the markets with which it works, and we know that the Federal Home Loan Bank would always point to the affordable housing program as one way that it meets their mission. AHP has a wonderful program. It is a tremendous support for our members and we rely on it for a private sector match that's leveraged millions and millions of dollars for affordable housing goals. But we believe the system can and must do more to meet its mission and its investors in low-income communities.

We've looked at a number of different indicators of measurement. One is the community investment program and the community investment cash advance. We've looked at the last five years of advances that the Banks have made, and the good news is that CICA and CIP advances increased almost 200% percent between 1998 and 2001. Up to $18 billion total and $5.1 billion in 2001.

However, our concern is that it fell almost 50% last year and 2002. And the larger concern is that community investment advances remain a very small percentage of the total advances of the Bank System. For a number of the Banks, it's less than 1% and for most of the Banks, it's less than 2%. Only the Federal Home Loan Bank of Boston has ever, in the five years that we've looked at the data, gone above 5% of the total advances for community development.

So our concern is all Banks have the same requirements to balance safety and soundness while meeting its public purpose. They all have the same primary tools, fungible cash that serves as loans, equity investments, or recoverable grants. So why are the differences so stark? And one reason -- one area of concern for us is that we believe there is inadequate participation of community development experts on the Boards of the Banks. We have worked for many years to research and promote and nominate candidates who have extensive risk, high finance, economic development and housing expertise, working in distressed urban rural and inner-ring suburban communities around the country. In fact, 21 of our candidates might be considered today at the 2 o'clock hearing.

Many of the ones that we had nominated were not reappointed in the last couple of years, and they have not been replaced with similar candidates. And for us, continuity is very critical to understanding the Banks, their finances, and it takes a long time to get a new initiative off and running because we believe when the Banks are making decisions on how to best meet the capital needs of their communities, they need the advice and counsel of people who know how to make profitable investments in low-income communities and under-served areas.

In relation to monitoring, we believe the community development practitioners on the Boards are one clear strategy to monitor how the Banks are meeting their mission through appropriate measurement techniques. And the system regulator should also be the one able to explain how the Banks are meeting their public purpose mission. And then the regulator should also be suggesting strategies to encourage performance among the Banks.

Now, many would say that -- some would say CIP and CICA might not be the best measurement tool for how the Banks are doing in meeting their mission requirements. You could look at the total number of advances in low income areas, or you could look at low income areas by census tract. You could promote the use of innovative and flexible programs like the MPF or the MPP, Native American lending -- we're very interested in economic development investment.

This is a critically under-used -- utilized opportunity the Banks have that's different from the other GSEs. And while economic development investments are increasing, the 2002 data indicate that five of the Banks invested more than $99 million in economic development investment. And we're very interested in that and we'd like to see sort of what they're -- what they're working on.

We think maybe one of the best ways is that you as the regulator request each Bank to submit community lending plans, and these plans are submitted by the Banks and yet nothing that we can find ever seems to happen with those. You don't -- the Boards of the Banks or the regulator doesn't go back every year and say the Banks say they're going to accomplish these goals. How did they do at accomplishing these goals? And that's one place that we think accountability would be -- would be very useful.

Finally, in decisions regarding changes to the regulatory agency, we suggested nine guiding principles which include that regulatory change should result in greater mission investment activities in housing, both multi-family and home ownership, community economic development. Regulatory change should enable community financial institutions like credit unions or banks and thrifts to meet communities' credit needs, especially in under-served communities.

Regulatory changes should encourage innovation in the development of financial products, and regulatory change should -- could curve or discourage predatory lending, which is a serious concern of ours. In many communities, predatory lending is undoing community development. Baltimore, for example, had more foreclosures than they had home sales in recent year.

Regulatory change should also recognize the difference between Fannie Mae, Freddie Mac and the Federal Home Loan Banks, and we also support a strong independent regulator and we would support reversing three components of Gramm-Leach-Bliley and how we think they've affected the Boards, has weakened the Boards. And we would increase the term back to four years for public interest and community interest directors because continuity and knowledge of the system is very important. We would raise the directors' fees and get rid of that cap. And we would appoint the public interest directors as chairs or vice-chairs.

We believe that having the leadership of the public interest directors ensures that mission is a primary focus and insures a collegial and collaborative relationship among each of the Boards which we think is very important to increasing the funding and investments in community development.

In conclusion, the Federal Home Loan Bank System has been a crucial source of funding for community development investment over the past years, and without the financing of developments that the bank members of the Federal Home Loan Bank System provide to community-based organizations, the situations in many of our communities would be dire indeed. And the dramatic increase in community investment by some of the Banks should be celebrated and it should be analyzed and encourage similar activities among other Banks. Yet, we believe the system can be improved because the Banks are capable of so much potential, and the regulator, we believe, has a critical role to promote that.

Chairman Korsmo and members of the Finance Board, that concludes my testimony. I appreciate the opportunity to appear before you today.

CHAIRMAN KORSMO: Thank you, Ms. Wayman. Our third member of this first panel is Robert D. Broeksmit, who is President -- am I doing all right on that?

MR. BROEKSMIT: Beautifully.

CHAIRMAN KORSMO: Thank you. Is the President and Chief Operating Officer of B.F. Saul Mortgage Company. Mr.

Broeksmit is here today representing the Mortgage Bankers Association. Bob?

MR. BROEKSMIT: Good morning, Mr. Chairman and members of the Finance Board.

I would like to add that B.F. Saul Mortgage is a subsidiary of Chevy Chase Bank, which in turn is a member of the Federal Home Loan Bank of Atlanta.

Thank you for inviting the Mortgage Bankers Association to discuss whether changes to your regulations or revisions to the Federal Home Loan Bank Act would enhance governance of the Banks. We think you are doing the right thing in looking for ways to improve the safety and soundness of the system through effective supervision of the activities of the Banks. After the unprecedented mortgage volume of the last year and the unusual level of focus on the housing GSEs, the time is right for a reevaluation.

That reevaluation should be undertaken with a view toward enhancing the successes of the recent past, while minimizing any risks that have come with them. MBA believes it is critical that the Board focus its efforts as much on the former as the latter. Specifically, we urge that you preserve and encourage the prudent development of the mortgage partnership finance and mortgage purchase program initiatives. We believe that these programs represent the major step in the evolution of the Bank System in the last decade.

The continued health of the mortgage programs is essential to the ability of the Banks to satisfy the statutory mandates of the Federal Home Loan Bank Act. MBA's members are the partners of the Banks and their mortgage acquisition programs and through these programs, the Banks have added an important -- an important element of competition in the secondary mortgage market. We believe that the MPF and MPP programs have been useful for the Banks' members and for homebuyers and have created vital funds for affordable housing.

Not only have the Banks contributed to lowering mortgage costs through adding another outlet for mortgages, they have developed an innovative risk-sharing mechanism. That kind of innovation is the basis for progress in continuing to make the mortgage system even more efficient. The positive achievements of the Banks -- the positive achievements the Banks have accomplished for their mortgage members -- sorry, for their members through the mortgage programs are extensive. The large members of the Banks generate the critical mass necessary to make the mortgage programs viable and they appreciate having another execution option for the sale of their mortgages.

Smaller members of the system also benefit in a variety of ways. Small lenders tend to know their customers. They are willing to accept the credit risk on their mortgage loans instead of paying MBS guaranty fees they see as high compared to the real risk of loss. The Banks' mortgage programs give them that option. The mortgage programs also allow small lenders to maintain their customer relationships through servicing their loans where many competing execution options either impose minimum delivery levels for retaining servicing or require that the servicing be released.

In these and other ways, the Banks have used the mortgage programs to provide broader choice, more business opportunity and additional mortgage funding for members. For homebuyers, more competition means lower cost of home ownership, and for those in need of affordable housing, 10% of the profits generated by the MPF and MPP programs are directed to serving that population. Those profits have allowed the Banks to be among the largest private sources of funds for affordable housing.

The challenge for the Finance Board is defining the line between prudent regulation and chilling micro-management or unnecessary risk aversion. This task is not static because the Banks have grown significantly in the past ten years and the categories of assets on their balance sheets have changed dramatically and become more complex.

In addition, the industry as a whole is struggling to incorporate change in accounting standards and to the presentation of our financial results. MBA believes that it is important that the Finance Board distinguish between unintended accounting consequences and risk-prone investment practices as you assess the performance of the Banks.

In your announcement of this hearing, you reference the June report of your staff and the conclusions reached with regard to the Boards and the operations and risk-management practices of the Banks. MBA has the following observations to make about governance of the Banks. First, the staff notes that some of the members of the Boards of Directors of the Banks lack experience in capital markets and some also do not have the time, training or financial incentive to acquire a working knowledge of the business of the Banks. We believe that the Finance Board should establish baseline standards for qualifications for members of the Boards of Directors of the Banks.

The staff also mentions technology investment, including the development of risk-management models and the hiring the experienced staff as an area that requires more attention from some Banks. MBA believes that to preserve the financial health of the Banks, the Banks themselves must all be brought to a standard of competent evaluation of the risks of their business practices. Here again, MBA believes it is the role of the Finance Board to establish the benchmarks which the Banks must reach. The Finance Board itself must have the must up-to-date tools for performing its regulatory function and determining how the Banks should perform their internal due diligence.

In order to be up to the necessary standard, the Finance Board will need to evaluate its own expenditures for risk management, training, and evaluation to determine if this critical function is adequately funded. MBA also suggests that the Finance Board examine the merits of a relationship between the Finance Board and the Federal Financial Institutions Examinations Council, the members of FFIEC individually, and with the Office of Federal Housing Enterprise Oversight. All of these regulators and the Finance Board are engaged in the difficult work of regulating sophisticated financial entities, and we believe that the sharing of these duties would be beneficial.

In summary, MBA believes that the Finance Board should handle its responsibility as a regulator with the objective of allowing the Banks to serve their mandate in a safe and sound way by establishing the quality control standards to which the Banks must adhere. Those standards should be devised to shore up any management shortcomings that some of the Banks might have on their Boards or in their internal management. The Finance Board then must hold the Banks and their Boards to the prescribed standards.

But the Banks have done great things for housing in recent years, and they made money for their shareholders at the same time. We urge the Finance Board to act in such a way that the Banks can continue to serve the needs of their shareholders and the needs of the American public in the creative and effective manner that has characterized the Banks since the inception of the MPP and MPF programs.

Thank you for the opportunity to present the views of the Mortgage Bankers Association.

CHAIRMAN KORSMO: Thank you, Mr. Broeksmit for your very insightful testimony, and I can call it insightful because I agree with so much of it, particularly the point incidentally about membership for the Finance Board on FFIEC. I made the same proposal when I testified. I can't recall whether it was before the Senate Banking Committee or the House Financial Services Committee or maybe both. I think it would be very helpful for our supervisory representatives to have the opportunity to serve on that -- on that panel, and I hope Congress responds not just to my proposal in that regard, but also to the proposal by those have friends at the system. I think it would be a very important adjunct to our -- to our function.

Let me open with kind of a -- with perhaps a broad-based question. Ms. Wayman touched on something of the although limited, nevertheless schizophrenic aspects of Gramm-Leach-Bliley in that the legislation in large context sought to devolve the responsibility for making management and operational decisions away from the Federal Housing Finance Board toward the individual Banks. At the same time, however, it capped the compensation available to directors. It limited the terms of public interest directors -- what was the other, the third point? Oh, it took away -- and that probably was appropriate in the sense that it has -- it has allowed Boards of Directors to elect their chairs and vice-chairs. I'm not sure what impact that has had in terms of changing the representative mix between the 60% who are elected directors and the 40% who are appointive directors. I know there are some Banks, for example, who recently have elected appointed directors as chairs or vice-chairs, but it probably had some impact.

I noted with interest that Secretary Snow in his testimony to, again, I believe the Senate Banking Committee, on proposals to change the regulation of government-sponsored enterprises had suggested that it is the Administration's position that the Administration no longer appoint directors to the Boards of Fannie Mae and Freddie Mac and that some new process be devised to take that responsibility, if you will, to borrow Director Mendelowitz's term, take the politics out of those appointments.

And I wonder if it isn't time, given the fact that this is a debate that's ongoing and part of the reason we've scheduled this hearing at this particular time, although some will recall that originally we'd hoped to have these sessions last October and got sidetracked by Congress's new interest in oversight of the Federal Home Loan Banks. It had distracted us. We're getting back on track now, but it remains timely because that discussion goes on in Congress, and the opportunity we have today and next month to focus on these issues perhaps will give us a chance to have some influence on that discussion.

Is it time -- and I will ask any of the panel members to comment on this -- we've spent a lot of time focusing again on the 40% who are PIDs. We spent less time focusing on the 60% who are elected. We can go to that in a minute, but is it time perhaps to devolve responsibility for the makeup of the Boards to the individual Banks. In other words, I alluded to this in my opening comments. The Banks have very different makeups. Some have many more members, for example, than the others. Some are substantially larger than the others. Some have a different balance sheet mix than the others.

Carol, you alluded to some are more aggressive in the use of the prerogatives they have for community development than the others. And we could speculate about what accounts for that, the difference among the 12 Banks, but is it time, perhaps, for us to recommend that responsibility for appointing directors -- or let me put it this way. Let's take the word "appointing" out of it. The time for establishing a process by which outside directors who are not representative of the membership of the individual Banks is devolved to the individual Banks. Carol?

MS. WAYMAN: We would -- we would oppose that. I mean, we would be very concerned. The Banks already have quite a bit of prerogative in choosing Advisory Council members, for example. But we believe that the regulator has a critical role to ensure that national standards are being met with regard to risk in the capital market, ensuring diversity among the Bank Boards is one of our critical concerns with the elected appointments.

A majority of the Banks, very few minority serve on the Bank Boards and very few women and that was one of the reasons that we like and believe that the regulator has a critical role to play and should -- should really focus on making sure that diversity and the skills that are needed and those folks are appointed to the Banks.

CHAIRMAN KORSMO: So your concern would be that if that responsibility was devolved to the regions that without, let's say, some specific requirements for membership, that the opportunity to create -- the opportunity to have a more diverse membership on the Board -- Boards might be lost?

MS. WAYMAN: Oh, absolutely. For us, as a non-profit association, it would be ideal to pick our own Board members, but we don't have that prerogative. We're a membership organization and our members vote through a very competitive process to be on the Board and we believe that the Finance Board has some serious responsibilities there.

CHAIRMAN KORSMO: David, Robert, any thoughts on --

MR. LEDFORD: Yeah, I -- we haven't developed a position on that question -- let me just say that first. But we are clearly concerned about the political influences on the process that has been in evidence in recent years and we'd like to see that change. I'm not sure giving it all back to the Banks is the answer either. I agree with Carol in the sense that we're concerned about what the Banks have done with regard to appointing their advisory committees. We think in almost all cases the range of experience on those advisory committees and councils, the range is very narrow. It's almost always a not-for-profit representative or someone from a governing agency.

CHAIRMAN KORSMO: Well, Carol likes that, though.

MR. LEDFORD: I know. But we feel that the Banks would tend to continue that type of approach with the public interest directors as well, and we certainly feel that it is important to have some private for-profit experience which, in many cases, is broader and more extensive in terms of how to successfully produce affordable housing at the least cost and risk quality. So I would be concerned that the Banks had sole responsibility for the appointments.

CHAIRMAN KORSMO: But for the opposite reason that Carol has, is that right?

MR. LEDFORD: Yes.

CHAIRMAN KORSMO: Bob, you want to break the tie on this?

MR. BROEKSMIT: Not exactly, but I do just want to reiterate that we think that you should set some standards. Now, that doesn't mean that the standards for a home loan

Bank that has 2% of its balance sheet in mortgages should be the same as one that has 50%, and I think you should be sensitive to the differences in each Bank as you -- in other words, I don't think that there's one standard for directors of all 12 Banks. I think a Board of Chicago ought to have a lot more mortgage expertise than the Board of a Bank that doesn't participate nearly as much in the program.

CHAIRMAN KORSMO: Other questions? Director Castaneda?

DIRECTOR CASTANEDA: I think this is a question I would like to ask each one of you. Can you suggest ways that director nominations and election practices can be improved to ensure that elected directors have the skills, experience and background to serve on the Board of an extremely large financial institution, and I think I'm going to -- I'm not going to ask you first, Carol. I would like to ask David first, if I may?

MR. LEDFORD: Sure. Well, I would agree with some of the comments that were made earlier that there probably should be some more explicit standards with degree of background experience and qualifications. But having said that, I wouldn't want to see that an absolute standard be set because you can get too far in that direction. I think it's just as important for these directors to have commitments to the housing needs of the nation, the housing needs of their district, as well as the skills to manage and oversee a complex financial institution.

So there has to be a blend of skills, and I wouldn't want to see people coming in, taking an advanced test to be able to – on derivatives and other complex financial instruments -- to be able to go further in the process. I think that might be too extreme. But there should be some basic level of experience and knowledge to begin with.

DIRECTOR CASTANEDA: Across the board?

MR. LEDFORD: And I don't believe -- yeah -- I don't believe that that's the case. Many of the people that are selected have no experience or contact with housing issues or financial institution management issues.

CHAIRMAN KORSMO: Let me jump in here for one second. Should the same rules apply to elective directors? I mean, there's no necessarily an assumption for --

MR. LEDFORD: Sure, they should, I mean but -- you would somebody that's being elected would have a fairly decent level of experience in the instruments and operations of these institutions, but sure, I think you should have -- should have some basic level of standards there as well.

DIRECTOR CASTANEDA: That's what I'm saying, across the board.

MR. LEDFORD: Yes.

DIRECTOR CASTANEDA: Okay. I agree. I think that was explained to me.

CHAIRMAN KORSMO: I’m sorry for interrupting. Carol, I think you were going to --

MS. WAYMAN: I think part of the nominations on making sure you find qualified candidates is really up to each individual director of the Finance Board. Many people usually sixty, seventy to a hundred submit resumes and then have -- spent time as each directors and their staff to work on a list that really addresses and meets the criteria that I think are very clearly laid out in past public documents. And then if you're finding that some Boards you just can't find appropriate candidates, you have a wealth of associations, like the three of us or others in the room who testified or sent in submissions that you should call and say, we really need a candidate with this sort of experience for this Board, and in the Finance Board, we believe every director should be much more aggressive in making sure that each Bank and each director has all the experience that they need to provide to that Bank.

DIRECTOR CASTANEDA: What about you, Robert?

MR. BROEKSMIT: I don't think I have anything constructive to add to what I've said. I agree with a lot of what David said in terms of not, you know, having requirements for a Board and for individual members. I think it's clear that you need different prospectives and God knows I wouldn't pass a derivatives test, either. I'm certainly not advocating that.

DIRECTOR CASTANEDA: Bob, thanks.

CHAIRMAN KORSMO: Questions? Dr. Mendelowitz?

DIRECTOR MENDELOWITZ: Yes, before I ask my questions, I want to thank the panel again for your time and your insightful input.

This question of how you get good directors, whether they be elected or appointed is, I think a really central issue because corporate governance, if it's world class, requires, as I said in my opening statement, best practices and highly-qualified people. I'm curious, what is your understanding of the process by which, for example, public interest directors get nominated and elected? What is the process? What do you think the process is? How is it done?

MR. LEDFORD: I can only speak to my personal involvement on it from the standpoint of the National Association of Homebuilders. Each year, we try to identify builders in our association -- members of our association that we feel would make outstanding directors and we forward those names to the Federal Housing Finance Board. We also forward them to the White House and members of Congress. We ask the candidates to try to do all that they can at the local level to build up support, both with the Federal Home Loan Bank there, as well as local officials, and just to try to get their profile to the point where it will be recognized.

There are so many good candidates, and in all honesty, the process can become very competitive. Many people would like to serve and so I think we urge our candidates to try to do all they can to try to stand out in that crowd. Beyond that, we're not sure exactly what happens. We've had some successes and felt that the members who were appointed have been good additions and contributed strongly. We have been disappointed, though, that most of them appointed by previous Administrations have not been reappointed, and we think that may have been just a judgmental thing without any review of their contributions.

So we'd like to see, as Director Leichter pointed out a greater review of the people and what they have contributed to their Boards before they're replaced without any further consideration.

DIRECTOR MENDELOWITZ: You mentioned --

DIRECTOR LEICHTER: I'm sorry -- could you indulge me -- could you just --

DIRECTOR MENDELOWITZ: I'd be happy -- I'd be happy to concede some time to my esteemed and honored colleague.

DIRECTOR LEICHTER: Do you think the system lacks at this time transparency and openness?

MR. LEDFORD: Well, all we see is the final meeting when the votes are cast and there's not a lot of discussion and debate usually when that happens. However, we do feel we've had the opportunity to have conversations with each of the members of the Boards to get their -- of the Finance Board to get their prospective, so I think from that standpoint, we do have some communication. I'm not sure how much involvement is even appropriate, so we feel that we get a good hearing and the decisions that are made, I think the decisions have been highly political, you know, not just in this Administration, but in previous Administrations. So that's just become I think part of the process.

DIRECTOR MENDELOWITZ: Thank you. Carol?

MS. WAYMAN: We would also -- I'll just speak for our personal experience that -- find that we do get a good hearing. We've been able to meet with each member and present our slate of candidates and get a very clear understanding of what the expertise required is. But we don't find it particularly transparent or clear which sometimes leads to confusion with -- especially this year -- with members of Congress.

So our members are writing to their Congress people and asking them to make calls and write letters to the Chairman and the White House. And we've been told by the White House that they're not involved and to send everything to the Chairman, and then other times, the White House is very clearly involved.

So trying to sort of separate that out and have a system that looks like it's very clear and open and participatory among all the members of the Finance Board directors, I think, would be helpful to the perception on Congress of how these decisions are being made.

CHAIRMAN KORSMO: Say that again. I'm not -- I'm not sure I understood what your point is. How exactly would we make it more transparent? You've both said you've submitted names, you've had a chance to meet with each of the directors. Directors are appointed in an open meeting. How could we make the process more open by your definition?

MS. WAYMAN: I think possibly being -- one example first was when our members had to apply in the whitehouse.gov website. It was sort of confusing that if the Finance Board is making the nominations, why are they going to the White House site.

CHAIRMAN KORSMO: I was curious about that as well.

MS. WAYMAN: Yeah, so that -- and then the White House denied -- that was confusing.

CHAIRMAN KORSMO: Have they finally given you the right answer this year?

MS. WAYMAN: Don't do it. That was clear.

DIRECTOR CASTANEDA: Don't go through the White House website?

MS. WAYMAN: Right. Just send to the Chairman.

CHAIRMAN KORSMO: I will say just so everyone will understand. I think there was some misunderstanding on the part of the White House early on in this Administration in that they were under the false impression that these appointments were Presidential appointments, as opposed to what the statute clearly says, that these are appointments that are made by the Federal Housing Finance Board.

Now that having been said, I think this White House is no different than any other. It likes to have an opportunity to provide input to the process, but I think they now understand that these are not their appointments which is why you'll probably get a different reaction this year than you may have gotten in 2001. That the same with you, Dave?

MR. LEDFORD: That's still confusing to us?

CHAIRMAN KORSMO: Going back to the question, though. Is there a way to make this process more open beyond what we do now?

MR. LEDFORD: The only other thing I can think of is just -- I'm not saying that the candidates that have been selected are not qualified, although -- are not going to do a good job. I think clearly a lot of them have had no previous exposure to the Federal Home Loan Bank System or the Housing Finance system or any other aspects of financial market expertise. However, I think there should be maybe a little bit more discussion or justification of each of the appointments of what qualifications this individual has that would make them a good director, and I'm not sure that's really -- that's been done up until this time.

CHAIRMAN KORSMO: Are you talking about in anticipation of the meeting or --

MR. LEDFORD: Both -- in terms of debating of the candidates and then when the candidates are selected. Just say this is why this person was selected.

MS. WAYMAN: And then qualifications would be helpful for us. I know when we've tried to follow up with some of the people who have been appointed, we've had not a really clear understanding of them or us and our role and also what their role is on the system. I know we've been trying to work with Carl Wick at the Cincinnati Bank, who was appointed two years ago to get some clarity on why the community investment numbers of the Cincinnati Bank have just dropped so precipitously in the last four years.

And then just contact information. When these people are being appointed, we work with 3600 CDCs and state associations and they would very much like to meet with these individuals and follow up and make sure they are aware of community development and it's very hard for us to get that contact information -- phone numbers, emails, faxes.

CHAIRMAN KORSMO: Do we not have those on our website? I don't think we do.

MS. WAYMAN: No.

CHAIRMAN KORSMO: Do the individual Banks not have their contact information for the directors?

MR. LEDFORD: Not in all cases. They have their name and affiliation, but not usually their --

CHAIRMAN KORSMO: If nothing else comes out of this hearing, I can guarantee that that will be a change that will be made. I'm sorry. I've interrupted Director Mendelowitz.

DIRECTOR MENDELOWITZ: I’m never offended by interrupting. I'm always happy to concede my time, as long as I can just get back to --

CHAIRMAN KORSMO: All right, let's get you back. I apologize.

DIRECTOR MENDELOWITZ: I appreciate the apology, but you never have to apologize, Mr. Chairman. I think this is sort of a free open and flowing discussion.

[11:06 a.m., Commissioner John C. Weicher joins hearing]

CHAIRMAN KORSMO: Commissioner Weicher, welcome.

COMMISSIONER WEICHER: Thank you.

DIRECTOR MENDELOWITZ: The question I asked really wasn't a trick question. I asked it because I'm about to say something that no Washington official is supposed to do, and that is, admit to their own ignorance and impotence.

I asked what the process was because I frankly have no idea what the process is. If the selection of public interest directors, as provided by the statute, were the selection of the Finance Board, I would expect that the Board members would sit together and reason together in a common effort to identify the best possible people and in my three years on the Board, this has never happened. I suggested names of people who I felt were highly qualified, but we've never had those discussions amongst the Board members. The list just appears.

And then as Lyndon Johnson will tell you, or if he were alive would tell you, the first lesson in politics is learning how to count. And I learned early on in my life how to count to three. And basically, what that means is the selection of public interest directors hasn't been a deliberative effort on the part of the Boards -- the Finance Board. It's just been something that happened and was determined by the ability to count to three at voting time.

And I really think the world has changed. I think Mr. Broeksmit pointed it out very well. And I really liked the way you characterized the differences between the Banks and the differences and the complexity of the balance sheets. There are some Banks that have fairly uncomplicated balance sheets and require a lower level of financial sophistication for good corporate governance. There are other Banks that have as much as 50% or more of their assets in mortgages, and we all know that mortgages are the most complex financial instruments around. And these institutions to manage that risk on the balance sheet engage in the most complex of hedging operations. And those Boards need public interest directors who have very specialized financial skills to make sure they can fulfill their responsibilities.

We haven't had the deliberative process to ensure that that, you know, happens. So I have a serious concern. The world has changed. One, Gramm-Leach-Bliley, as you've pointed out many times, Mr. Chairman. I think the very first thing you said when you got here and became Chairman was "we are the arm's-length regulator." There should be a bright red line between the regulator and the Banks. The Boards of Directors are the first line of defense in ensuring a well-mannered safe and sound system.

Well, because of that stance, because of Gramm-Leach-Bliley, because of the growing complexity of the balance sheet, we can't do things they way they've been done for the past 70 years.

Looking forward, we have to change the way we do things with the objective of making sure that the Boards of Directors have the skills necessary to fulfill their corporate governance. And I think you've described exactly what the problem is and I really appreciate it.

And this issue -- I'll give you examples of some. I'd try to divine after the fact what the process was so when I met new public interest directors, I asked them how they got to the -- appointed as members of the Board of

Directors. And I'll give you a representative example. One member of a Board of Directors said that that person, and I'm deliberately trying to be vague because I don't want to single anybody out for a particular criticism or derision or anything. So I'm trying -- I don't want to use gender. I'm just giving you a specific example.

I asked one director, how did you get to be a director? And this director said, well, I'm the Chair of the Republican party of my state. The White House contacted me and said come up with some names for public interest directors for Home Loan Bank. And this director said, well, I looked at the Home Loan Banks and I said, gee, that looks interesting. I'll do it.

That's not the deliberative process that the Finance Board should be pursuing to ensure that we have the right people on Board to oversee the governance and safety and soundness of a complex financial system with over $800 billion in assets. The taxpayers are at risk and I'm looking for your advice, you know, how do we do it better? I mean, how should we do it better? But if you want some time to think about it --

CHAIRMAN KORSMO: Well, it's an interesting monologue, but is there a specific question that this panel might be able to address other than, I guess, we've talked about this. Ms. Wayman was asked the question about define how we make the process more open to meet the -- to accommodate the concerns that both David and Carol had raised.

MS. WAYMAN: I think the justifications for individual candidates would be helpful. Possibly listing or making it available for the people who were considered for nomination for each of the Banks would be helpful. And then making sure internally that all five directors are involved in presenting candidates would be our highest priority.

DIRECTOR MENDELOWITZ: How would you suggest we find -- how would you suggest we establish a standard in terms of what skills are needed by directors for a specific Bank. What's the process of collecting that information and making a determination?

MR. BROEKSMIT: Well, I think again, you have to look at -- I don't suggest they're 12 different standards for 12 Banks, but I think you can group the Banks by size or by complexity of balance sheets as we've talked about, and there may be two or three standards. But I think that you really need to look at what you're expecting this Board to do.

If you're expecting the Board, as you mentioned in the case of a Bank that has mostly an advanced business that hasn't changed much over the years, unlike all the comments we've made today about how things have changed a lot, then if you have a Board that represents the geography of the Bank that's covered and perhaps look for some variation in terms of size of institution so that you don't have a Board dominated by the smallest members or the largest members.

But in terms of the expertise, which is what I think you're really looking at, I think, back to David's comment about not passing a derivatives test, Chicago needs one or two guys who could, I think. And some of the other Banks might not, but should have somebody and whether it's statutory or part of the regulation that there has to be one, we could debate whether that's the right way to approach it, but certainly there should be expertise so that whoever is handling the day-to-day hedging operations going back to the mortgage side for the Bank can't just make a Power Point presentation at the Board meeting and everybody nods and smiles and off you go.

Somebody on the Board -- somebody or some people on the Board have to be able to engage that person as peers with a deep understanding of the complexities of the financial transactions being undertaken and make sure the controls and processes are in place to avoid problems which -- fluctuations in interest rate, which I think is primarily the rate risk and prepayment risk are the real risks for the Banks. They don't have any credit risks on these loans. Well, they have some, but I don't view it, as somebody who understands how those programs work, I don't view that as the big risk. I view it as an interest rate risk and a prepayment risk.

Somebody on the Board has got to be able to go toe-to-toe with -- whether it's an employee or a consultant or whoever they have doing this work. And I think this is a challenge that not just the Home Loan Banks, but anybody involved in portfolio lending, having loans on their balance sheets, has a pretty good control both on the Board and in the operations of the Bank on this process. And those that don't are the ones that you'll read about that have problems with mismatched hedges or leaving themselves exposed to big interest rate fluctuations.

CHAIRMAN KORSMO: I think we all agree that the challenge is how do I identify the people who can fill those roles and equally to the point is how do we ensure whether they are elected directors or appointed directors that those people that are in place on the Boards of Directors of those Banks where those skills are required. The trick is -- we all recognize that it needs to happen. The trick is how do we make it happen and that's one of the reasons why we're here today.

Are there other questions for this panel? Franz, did you have any questions for the panel specific?

DIRECTOR LEICHTER: Well, I just want to say that Carol and Dave, you referred to it -- about making recommendations and for public interest directors not finding out what happens. Let me tell you, that as a Board member, I've had the exact same experience. Make recommendations and frankly, there's a big, black hole here where most of these recommendations fall and they never receive the scrutiny, Robert, that you've talked about and so on.

So I think it's extremely helpful to have these recommendations, to hear your complaints, particularly since this afternoon, we're going to go through this process. So we'll have a chance to see whether we've learned anything. I just want to say besides the very valuable comments on governance, all of you made other suggestions which were certainly helpful to us.

Robert, you talked about the value of the MPF and MPP program. Carol, I very much appreciate you and your organization's commitment to economic development, and you know that this is something that I've been urging the Banks to be more vigorous on. And Dave, thank you for addressing the problem of the -- or the initiative of the, as you've said, the ACD loan, and I think particularly, since you and I have talked about this, if you can isolate the construction aspect of the ACD. I agree with you. I think that's not a particularly risky loan, so I think from that viewpoint it's helpful.

I really appreciate the support all three of your organizations have given to the Home Loan Bank System and the interest you have it. It's an important system, important to keep it functioning well. And important to see that the system, through its governance, meets the needs of its members and the needs of the public.

Thank you.

CHAIRMAN KORSMO: Thank you, Director Leicher.

DIRECTOR MENDELOWITZ: Oh, I'm sorry. I didn't want to jump in with a question, but I don't want to get passed over, but Dr. Weicher hasn't had a chance to ask a question --

CHAIRMAN KORSMO: I was going to ask. Thank you, Commissioner Weicher for joining us. Obviously, you weren't here to hear the oral testimony. I know you're familiar with the written testimony. Is there any question you would have of this panel before we thank them and get the second panel in?

COMMISSIONER WEICHER: Just one or things. First of all, I want to apologize for not being here for your presentation. It was unavoidable and I do regret it very much. I might say that I've met on a number of occasions with both Mr. Ledford and Ms. Wayman both on issues relating to the Finance Board and the System and issues relating to HUD and FHA as well. And I’ve certainly met with MBA leadership and staff on all of these issues as well.

It seems to me that our role here is much like my role at HUD. We are responsible for regulating a set of financial institutions which have a specific public purpose. They have special status because they are here to do things that we, as a society, have decided through the political process deserve special attention. And there always comes a balancing act. How much risk should one take in the pursuit of the public purpose? There is certainly an implicit judgment and sometimes an explicit judgment that in serving the public purpose, you, the financial institution, don't lose money. You, the financial institution, operate prudently with the authorities you have.

So it becomes a balancing act of risk on the one hand and public purpose on the other. And the testimony just kind of touched on in passing, I think it's fair to say, by you all. Do you have a sense of the extent to which -- the extent to where that balance is now and where it might be? This applies both to us and of course to the directors of the individual Banks?

MR. LEDFORD: Well, with regard to that, I didn't touch on this in my oral statement today, but we did comment on the --

COMMISSIONER WEICHER: Was that in your written statement?

MR. LEDFORD: On the formal statement about the new risk-based capital system and that we did strongly support that, both in the statute that required it and we appreciated the opportunity to work with the Federal Home Loan Banks and the Finance Board and their staff as those regulations were developed and we feel that a good system was established and it will be interesting to see how it moves forward.

But we were very concerned under the prior capital regime that the system was greatly over-capitalized and there was a lot of boasting about never having lost a single dime on any individual loan. And I'm not sure that’s, you know, many financial institutions that compete could stay in business if they operated that way. You have to take some risk and that's why we like the risk-based capital system where other activities could be undertaken if appropriate capital is set aside to account for that risk.

So we think we're on the right track -- the system's on the right track with that process. The Banks are just now implementing these plans and of course, it's complicated by the definition of capital within the system and sort of a unique composition of that, but NHB thinks the system's moving in the right direction and the system that was put in place was based on the state of the art at the time. I think it should continue to evolve as improvements and innovations occur in thinking about capital for financial institutions.

So that's the position we have on the capital side and on the risk side, but we – we think the Federal Home Loan Bank should take some risk if it's adequately capitalized.

MS. WAYMAN: We would – we would agree that the Banks need to take more risk, I think, on the balancing act of the seesaw of safety and soundness on one mission and on the other, our testimony is pretty much focused on -- it's way up there on safety and soundness and way down on mission. And we'd really love to see more attention paid to measuring mission and monitoring those achievements.

MR. BROEKSMIT: I don't think I have anything useful to add. I think they've both said it well.

CHAIRMAN KORSMO: Are there any other questions specifically for members of this panel? Director Mendelowitz?

DIRECTOR MENDELOWITZ: Thank you, Mr. Chair. I think you've captured quite correctly, you know, how do we get the right people? That's really the question. I know how to get the right public interest directors. That's easy. We pick them. The people sitting around this table pick them. We just have to pick the right people.

The reason why that proposed reg was put out dealing with being able to pass a derivatives test if you want to characterize it that way was quite honestly, the idea would be what you articulated. Everyone on the Board of Directors had the financial sophistication to understand the balance sheet and fulfill their responsibilities. But we're very far from that goal. I've had members of Boards of Directors tell me that they sit on boards where not a single elected or public interest director has the ability to understand the balance sheet. And that proposed reg is a first step at trying to remedy that situation.

I'm interested in whether anyone here has suggestions on how we might consider regulatory changes that would help assure that the elected directors also have the skills to do the job.

MS. WAYMAN: I'm not sure about regulatory changes, but if there is some sort of training mechanism that the Finance Board could put in place. I know you have -- I think there's only one meeting in the beginning when people are appointed to sort of train them, but if it would be ongoing, it --

CHAIRMAN KORSMO: Each of the Banks has a -- has a fairly extensive training program for the Board members but --

MS. WAYMAN: And the Finance Board --

CHAIRMAN KORSMO: -- even in the wake of that, you still have this situation. And I think you touch on an interesting point because I've had the same conversations where I've expressed to an -- to an elected member of a Board of Directors my concern about finding appointed candidates who have this kind of background, and the comment I've gotten back is, well, we should be equally concerned about the financial acumen of elected directors because there is certainly nothing in that process either that guarantees, beyond the fact that they're employed by member institutions, that guarantees that any given elected director has the financial background to -- Robert made the comment, I'm not sure I could pass a derivatives test. Well, neither am I.

So it's a -- it's a problem that's common to boards in general and certainly not specific to the appointive directors at all.

MR. LEDFORD: Well, that sort of gets back to Director Castaneda's question earlier that -- that there should be something across the board. You know, I think it needs to be a blend of objective and subjective criteria because when you get into absolutes, then you know, decisions could get very capricious and exclude people that could be very valuable contributors. But there should be some minimum capacity, both -- both for the financial knowledge and the housing and housing finance interest and knowledge and I think that would be very helpful.

CHAIRMAN KORSMO: We've kept you sitting in the chairs for an hour and a half. That's probably torture enough. David Ledford, Carol Wayman and Robert Broeksmit, thank you very much. We appreciate your testimony, and we appreciate your being here on behalf of your organizations. We appreciate your interest in the Federal Home Loan Bank System. Thank you very much.

MR. BROEKSMIT: Thanks for the opportunity.

MS. WAYMAN: Thank you.

CHAIRMAN KORSMO: With that, if we could call our next panel to the table.

[Off the record.]

CHAIRMAN KORSMO: Back at full strength, and I suspect, quite literally, after a brief break, and we welcome the members of our second panel. We’re privileged to have with us representatives of two, more -- two additional organizations that represent the members of the Federal Home Loan Bank System, representatives from America's Community Bankers and the Independent Community Bankers of America. We're pleased to have with us both J. Edward Norris, who is Chairman, President & CEO of Plantation Federal Bank in Pawleys Island, South Carolina and David Hayes, who is with us from his bank in Tennessee.

Ed, I think you drew the short straw, so you're first.

MR. NORRIS: I'm honored. Mr. Chairman, distinguished members of the Finance Board, I am Ed Norris. I'm Chairman, President and CEO of Plantation Federal Bank in warm Pawleys Island, South Carolina. I presently serve as Chairman of America's Community Bankers Government Affairs Steering Committee. I'm a past Chair of the Federal Home Loan Bank System Committee. I've just completed an eight-year term on the Federal Home Loan Bank of Atlanta, having the distinct privilege and honor of serving as Chairman this past year.

ACB appreciates the opportunity to comment on ways to enhance the governance of the Federal Home Loan Banks. The continued financial health and viability of the Federal Home Loan Bank System is virtually important to all ACB members and ultimately to our customers, the American homeowners. Therefore, ACB commends the Finance Board for taking this initiative. Your initiative is timely for several reasons.

First, the Home Loan Banks themselves have become increasingly complex. The system's membership and activities are continuing to expand and to move in new directions. And our policymakers are placing increased emphasis on the importance of good governance. Today, I'll present several recommendations for America's Community Bankers, but I want to emphasize that our members who own over 50% of the capital in the Federal Home Loan System will continue to take a close look at all of the issues and to provide the Finance Board with additional ideas in the future.

First, we know that the Board already has some flexibility to enhance the qualifications of Federal Home Loan Bank directors. Except for requiring that two of the six appointed directors represent consumer or community interests, the law imposes no categories or specific qualifications for directors. We believe that the Finance Board could and should appoint directors who are well qualified to oversee the Home Loan Banks' increasingly sophisticated business activities. If the Finance Board or the individual Federal Home Loan Bank determines a particular type of expertise is needed, the Finance Board should retain the flexibility to appoint specific experts in appropriate numbers as their needs appear on the district Bank Boards.

ACB was pleased to learn from your report on governance that the Finance Board is already exploring that idea. In addition, we know that some qualified candidates for appointed directors are not eligible to serve unless they divest themselves of their stock or equity investment in member institutions. That unduly limits the ability to recruit knowledgeable and informed candidates. Therefore, we recommend some additional flexibility in that area.

ACB is also concerned that stockholders are not always adequately represented on the Boards of the Federal Home Loan Banks. One way to address this was to ask the stockholders who own the system to vote on non-financial institution directors, who are now appointed by the Finance

Board. We understand how the votes binding would require statutory change. The Finance Board and other policymakers may also wish to reconsider whether it make sense for any government official or agency to appoint Home Loan Bank Board members.

Chairman Korsmo, you indicated that Treasury Secretary Snow had told a Senate Banking Committee last year that the Administration is committed to making sure that directors of publicly-traded corporations, like Fannie Mae and Freddie Mac, are elected by the shareholders rather than selected by the President. If Congress eliminates Presidential appointments to the Board of Fannie Mae and Freddie Mac, it should also consider eliminating the appointment of Home Loan Bank directors by the Finance Board.

The Finance Board's governance report noted that the formula for determining the number of votes a member may cast in a director election, "favors the smaller members and disadvantages the larger members." ACB does not yet have a position on whether larger members should be permitted to vote a greater amount of the shares, but we do recognize that the current limits encourage broad participation, and that's the hallmark of the Federal Home Loan Bank System's cooperative nature.

Structural changes in the system's membership over the last 15 years have dramatically diminished representation of active, more qualified system users on the Board of the Home Loan Banks. In the past, smaller members typically were active users of the services of the Home Loan Banks, and they had substantial stakes in equity in the Home Loan Banks. As a result, elected directors, whether from large or small institutions, they have similar knowledge and similar interests.

Banks are very different today. Since FIRREA, the system membership has greatly expanded and many members have a minimal stock investment and make minimal use of the system. Without question, the current prevalence of institutions that view their membership, excuse me, as a liquidity insurance policy or primarily as an investment for dividend purposes has diminished Board representation of the system's more qualified and active users.

Reallocating voting rights on the basis of size could be divisive and still not adequately address this problem. However, a potential solution would be to give institutions that depend more heavily on the system a greater voting power. In that way, knowledgeable, active users of the Federal Home Loan Bank System, particularly those that rely on the system's advances would be well represented.

Under this suggestion, a smaller member that uses the advanced window would gain influence, while a larger member that uses a relatively smaller percentage of advances for its funding would not. This should hold true even if the larger member had a greater absolute number of advances.

Mr. Chairman and members of the Board, again, thank you for considering our views. ACB would welcome the opportunity to provide more explicit and concrete recommendations on these important issues in the near future after our members have had a chance to review and consider all possibilities.

Again, Mr. Chairman, thank you again.

CHAIRMAN KORSMO: Thank you. I do appreciate your testimony. I know that you had raised -- I suspect you've raised a number of provocative issues that will prompt some questions, and rightly so. Before we go to those questions, however, let's call on David Hayes, who is Vice Chairman of the Independent Community Bankers of America, and the President and CEO of Security Bank in Dyersburg, Tennessee. David?

MR. HAYES: Thank you very much. It's an honor to be here today to represent the Independent Community Bankers of America.

Approximately a year ago, I was given the challenge of being the Chairman of the ICBA's Federal Home Loan Bank Task Force. And at that process, I said there are a lot of questions, but I don't have a lot of answers, but through that year, have gained a better understanding -- but recognize there are still more questions to be dealt with. But here I am today, particularly to give our prospective on the report of the horizontal review of Board governance of the Federal Home Loan Banks, which the Finance Board recently issued and the Community Bank perspective on how Federal Home Loan Bank governance issues should be dealt with in general.

My comments are based on our initial review of the report and we would be pleased to share with you any additional thoughts we develop as we move forward in our review. Like the vast majority of ICBA members, Security Bank is a Federal Home Loan Bank member. We have had a membership in the Federal Home Loan Bank of Cincinnati. Like other ICBA members, we have found the ability to borrow advances is extremely important to our ability to offer our customers residential mortgages and other loan products.

We thank the Finance Board for undertaking governance review of the Federal Home Loan Banks and for holding this hearing to discuss that report. A safe and sound Federal Home Loan Bank System is vitally important to community banks. We recognize that an important part of safety and soundness of any institution is a well-functioning and engaged Board of Directors. The Federal Home Loan Banks are no exception.

As we all know, the Federal Home Loan Banks are unique financial institutions, and therefore, have a unique corporate and governance structure. Congress has given the Federal Home Loan Banks a non-traditional board structure which calls for a certain ratio of director seats set aside for elected member representatives and a certain ratio for appointed representatives of public interests. We see this structure as appropriate to its Federal Home Loan Banks' function and purpose.

Congress had the opportunity to review and make changes to the governance structure several years ago when it passed Gramm-Leach-Bliley. While Congress chose to make some major changes to the system, such as its capital structure and member stock purchase requirements, it left in place its guidance regarding the allotment of Board of Director seats. The Federal Housing Finance Board reports notes concerns expressed during interviews regarding statutory and regulatory standards governing the election and appointment of directors. The report suggests that changes to the statute or regulation would be better made on a comprehensive rather than a piecemeal basis.

ICBA sees no need to seek comprehensive changes at this time, particularly since Congress had the opportunity to address these issues recently. Some of those interviewed expressed concern that the current formula for determining votes favors small members over larger members because limits were based on the average number of shares of the Federal Home Loan Bank stock required to be held by all members located in a state as of the record date. It is not that long ago that community banks regularly complained to the ICBA that they could not get their members elected to the Federal Home Loan Bank Boards because of the larger long-term members.

We think that the current formula for selecting directors, both elected and appointed, remains appropriate for the unique mission of the Federal Home Loan Bank System and its cooperative structure. From our observations, the ability to get elected, the stronger tie to the ability of member institutions to organize on a statewide basis to stand behind a single candidate per director seat, we would have concerns that the largest Federal Home Loan Bank users would likely dominate their Federal Home Loan Bank, both through governance and through their influence as dominant customers if they're allowed to vote all of their stock.

Not only do we see this creating safety and soundness and Board independence issues, but also it would make it far more difficult for community financial institutions to have a voice in their respective districts. We believe this is contrary to the wishes of Congress, which expanded community financial institutions access during the 1999 Act of Gramm-Leach-Bliley. Congress gave the Federal Home Loan Bank System a cooperative structure. And in a cooperative, it is important to give all members an opportunity to be represented regardless of size and amount of advances they borrow.

We continue to support the appointment of knowledgeable and engaged public interest directors who are able to provide a unique community perspective. We encourage the Finance Board to appoint these directors in a timely manner so as to ensure that they are able to begin serving as directors at the start of the year so they can fully participate in new director training. Some had suggested that the Finance Board should attempt to finalize appointments in December prior to the start of the new full terms of the Boards, and we find merit in this goal.

The ICBA is also concerned that the suggestion that Federal Home Loan Bank directors, management and employees be allowed to influence director elections. Some argue that these people are in a position to be informed about who among the director candidates may have the best skill set to be a director. Candidates from larger institutions often have desirable experience or expertise in interest rate risk management, and it is assumed that current directors, management or employees supported such director candidates that it would be to the benefit of the Federal Home Loan Bank.

We believe that any possible benefit would be overshadowed by direct conflict of interest, particularly when the candidate, if elected, can influence the compensation of the Federal Home Loan Bank employees who sought his or her election. In the current environment of increased emphasis on corporate ethics, this is not a path that the Federal Home Loan Bank should go down. If the Federal Home Loan Bank Finance Board sees the Federal Home Loan Bank directors as lacking needing expertise in interest rate risk management and use of derivatives and other more complex financial and risk-management tools, the Finance

Board should strongly consider this need when appointment public interest directors.

The Finance Board has conducted a new director orientation program that we believe is a valuable program. We encourage the Finance Board to continue it, but to enhance it to address issues identified in this review. We see the program as an important way to ensure that new directors are given needed training in a uniform manner.

We also support the Finance Board's plans to enhance examination procedures. The report contains a number of good suggestions that do not require changes in statute or regulations, but can be addressed as part of the Federal Home Loan Banks overall safety and soundness examinations.

For example, identified weaknesses in the internal audit function are certainly a safety and soundness issue that can be addressed in the examination. As a part of the examination, Board minutes can be reviewed by the Finance Board examiners to make a determination on how well management is communicating with Board members and how the directors are considering issues identified by the Federal Housing Finance Board that demonstrate Board effectiveness.

The issuance of this report itself is an important first step in communicating to the Federal Home Loan Banks and their directors ways to improve governance. The Finance Board's plan to prepare a booklet on Board governance for directors is another valuable step. In our view, the Federal Housing Finance Board has an important role to play in enhancing Federal Home Loan Bank governance and we encourage you to do so through guidance and examination, rather than regulation and legislation.

Thank you for giving the ICBA the opportunity to testify today, and I'll be happy to entertain questions.

CHAIRMAN KORSMO: David, thank you very much for that testimony. Appreciate it. I think the comments of both of these gentlemen who represent organizations whose members are members of the Federal Home Loan Bank System, compare that with the testimony of the previous panel, you see how all of this is a balancing act and a real challenge and makes our job not easier, but more difficult, more challenging.

Let me, again, exercising my prerogative to take the first question, harken back to a topic both of you touched on, the influence of management on any process, goes to some extent to the -- to the question of tenure, and again, we tend to focus on the public interest directors. Certainly, that's been the focus of debate about appointment

-- to reappoint or not to reappoint, that has been the question. But it's also an issue for elective directors.

Ed, you've had, as you mentioned, the privilege to serve for eight years, there is a statutory constraint on the election of directors. The directors -- the elected directors by statute are limited to three-year terms. They can admittedly sit out then for two years and come back.

But is there a point at which -- is there a point at which for any director, no matter how engaged, no matter how informed, is there a point at which it's time for a -- for a fresh perspective, and I'm not focusing now on the appointive directors, frankly, as much as I am on the elective directors, but also the implication for that as a whole and also to the extent to which that extended period on the -- on the Board for some directors may go to the point that David made in a different context about the influence that management then tends -- tends to perhaps have on a director who has served for an extended period of time. Is it a problem or isn't it?

MR. NORRIS: Mr. Chairman, it can be a problem. Would Ed Norris have liked to serve longer? Probably yes. Was it time to get back to my bank? Probably so. I was telling -- last summer on vacation, I had two calls from my bank and eight calls from Federal Home Loan Bank. So it is time consuming, and especially in a chair or vice-chair role.

The problems that I see in that is -- when I became Chair, I had 13 of 18 directors who had one year or less experience. And that range from appointed public interest directors who did not know what retained earnings were to qualified industry directors coming in who didn't understand the balance sheet of the Federal Home Loan Bank System. I spent in my year as Chairman -- let me add one thing before that.

Unfortunately, I didn't get the public interest directors even until February, so here was a year that we were putting together a three-year strategic plan with 13 directors who had one year or less experience in the Federal Home Loan Bank System and yet three of them, I didn't get until February. So, when we began our process in -- in April from the strategic standpoint, it involved a lot of training to bring this group up to a stage that they understood what was happening to put together the plan.

So in that way, I would never want to be in that situation where I had that many to train because it took the time of the Federal Home Loan Bank of Atlanta staff, it took a lot of my time, it took the Vice-Chair's time to educate those in there. On the other hand, because of term limits, we got new directors to replace some who really didn't have the interest or the time to serve. So, again it's a fine line. There is -- there is benefit in the term limits in there, but again, my personal opinion would be to maybe lengthen those some.

CHAIRMAN KORSMO: So the current statutory proposal that I think --

MR. NORRIS: Going to four years.

CHAIRMAN KORSMO: -- that I think Representative Kanjorski sponsored, you think that that's a good idea.

MR. NORRIS: I would certainly support it and I would think the membership of America's Community Bank would.

CHAIRMAN KORSMO: Two four-year terms for elected directors and appointed directors, would that make sense?

MR. NORRIS: Yes.

CHAIRMAN KORSMO: David, any thoughts on that?

MR. HAYES: We haven't taken a particular position on that at this time, but you know, having not sat in the chair Ed has in serving as Chair or a Board member of the Federal Home Loan Bank, I can only reflect personally as I've served on other boards, and as well, in serving in the ICBA, there is that issue that there is a period of time that you're there and you're sad to go.

But you also recognize that that constant movement of new blood engages an organization and engages the staff because people are going to ask questions that maybe I would have asked or Ed would have asked six years ago, which I think, continues to make the staff and management understand that they have a responsibility to report to a board.

And I think engagement is the issue. I mean, you can have board members no matter whether elected or appointed or whether it's the Federal Home Loan Banks or not for profit or whatever. And they're there as appointed and they appreciate the honor. But the engagement issue -- and I think your examiners can determine that when they go to the Banks and look at the Board packets and look at the Board minutes and engage the directors.

MR. NORRIS: One thing, if I might add. The benefit of the rookie, so to speak, is that you really have to go back and look at the System, and you have to keep -- management has to continually pound in there this is what it's about. And it forces them to go back and explain it and look at the situation because new blood is always challenging. When they don't understand something, as long as they're engaged and they don't mind asking the questions, then it's usually positive.

MR. HAYES: I concur. I mean, if you've got to explain it, you're going to be prepared for the questions. And I think a new person who may not be a financial expert -- well, they should have basic knowledge, but they're going to ask a question and it's not a dumb question because I mean, I think we can look everyday and see issues of boards that have experts that still missed it.

CHAIRMAN KORSMO: As we get concerned about the question of qualifications, and Ed, you alluded to this, and the statute requires right now, "no Federal Home Loan Bank director who is appointed pursuant to this subsection may, during such Bank director's term of office, serve as an officer of any Federal Home Loan Bank" -- well, that certainly makes sense, "or a director or officer of any member of a Bank," which also makes sense. Obviously, that's for the elective process, "or hold shares or any other financial interest," which we've interpreted as also receiving a pension from any member of a Bank.

And so we've had on several occasions, certainly people whose qualifications would have made them an excellent member of a board, largely retired financial services institutions people who have been disqualified from consideration by this point.

Now, there are also people, of course, who have those qualifications who own those shares of stock or getting a pension from a financial institution who have been active in Habitat for Humanity, have had an extensive -- as many bankers have -- have had an extensive community development background because that's what bankers do in communities and by virtue of this particular statutory requirement, have been disqualified. I guess I -- I take it I hear from your testimony, and David, I would assume you would concur that this is a limitation that if we had our druthers, we'd eliminate.

MR. NORRIS: Plus, I think there is a disparity between there because, being an elected director, I can own stock in any member institution, whereas public interest directors -- you're saying no.

CHAIRMAN KORSMO: Of course, there are requirements for disclosure and also for recusal then would apply. But why couldn't those same disclosure and recusal requirements apply to an appointed director?

MR. NORRIS: And generally, a person who owns financial institution stock is more aware of the intricacies or the working operations of a financial institution.

DIRECTOR CASTANEDA: That is a fact.

MR. NORRIS: Even if it's Bank of America.

DIRECTOR CASTANEDA: I think I would like to ask the two gentlemen here the question that I asked the previous panel. That is, can either one of you suggest ways that director nomination and election practices can be improved to ensure that elected directors have the skills, experience and background to serve on the board of extremely large financial institutions?

MR. NORRIS: David, you want to take this? I definitely have an opinion.

MR. HAYES: Well, I think mine may not be as definite, but I -- first of all, you know, you are elected by your peers. Okay? You're, you know, diverting people away from those other financial institutions. So you have to garner the respect of multiple organizations. To get to the issue of how much expertise is required or what minimal, and sometimes, you know, you say, well on the piece of paper, it looks like that person is an expert.

But in reality, they may not have all of the technical issues regarding interest rate risk or derivatives or those things. But they might be your best Board member in terms of engagement in asking the tough questions of management. So I think it's kind of hard to set down very specifics, but I think election by your peers, you know, you've got to have that respect. And how that process comes about, I mean, I think is important that you are then -- then assuming not only the responsibility you have, but that representing those other Banks.

So that doesn't answer your question particularly, but I have a tough time writing down, you know, these exact qualifications would have to be there for me to be able to run because I might ask tougher questions than the person who maybe understands everything about interest rate risk or derivatives. I mean I might force that person to explain it down to a very low level so I can understand.

DIRECTOR CASTANEDA: So they're breaking in --

MR. NORRIS: Well, my number one would be there needs to be some qualifications. Someone who becomes a citizen of the United States, there are qualifications that they have to -- at least can read and write and understand some -- and they have a history lesson. I think on any board -- my Bank Board, America's Community Bankers' board, ICBA's board, you want a diversification of skills. You don't want everybody who can do the same thing.

DIRECTOR CASTANEDA: No.

MR. NORRIS: Now, Director Mendelowitz, you mentioned before that you, as a Finance Board, had not done a good job of putting the right public interest directors in there. I respectfully agree and disagree. You sent me, as

Chairman of the Atlanta Bank, some very good public interest directors.

Now, did they have a background in derivatives or financial background? No. But the Chair of the my HR Committee was wonderful in that role in that she understands people, she understands the incentive, and she did a lot of things that we revised that she didn't have to have that financial background. You send a new Vice-Chair mortgage banker, but also political side. He chaired the government relations side. There's an expertise in talents in there. Bob Strickland, who is Housing, is a wonderful appointee. There is no one, I don't think, on any of the 12 District Banks that understands housing any better than he does.

So you have done a good job, certainly in sending some of them. But you have sent ones that get up 4 or 5 times to answer the telephone. I've sat through Board meetings trying to be intense on it and had a public interest director who reads the Wall Street Journal, you know, while the meeting is going on. So it can be very disruptive. Obviously, those people were appointed because of a political favor of some type.

But you've got some wonderful ones who are very engaged in -- that I'm very proud of with the system and as a member and stockholder of the system, I would say we've got great ones. Don't replace those in there. But I do think you need some type application or something to say where's the expertise coming in there, and is that expertise more than -- it's a minority or a political they gave X number of dollars or something like that. So I think you need to put that criteria out there.

DIRECTOR CASTANEDA: It's good to hear that even though not every candidate has been the perfect candidate, and I cannot take credit for that, the Board has done a good job with many of the people that they have elected as a public --

MR. NORRIS: I met through the Council and through my year a lot of really active, engaged public interest directors. So you haven't fallen short and it doesn't need a radical change back on it. But it does probably need some insight and again, I think something that this Board could do is ask the Bank, what is the area that you need? You know, is it financial? We have very few industry directors who understand the extent of $150 billion in derivatives, but now we have an industry director from a larger Bank who is engaged in derivatives. That helps a lot because everyone on the Board looks to him and says, you understand this, now tell me -- and he'll make the comments, yes, that's good.

MR. HAYES: You know, you go to the issue, like what I was trying to communicate. I mean, diversity is important on those Boards. Diversity of background, because when you come together and you're focused on that mission and your fiduciary responsibility, if you're engaged, whether you're the expert or not, I mean you're going to be driven to get the answer. And it is good to have Board members who have that expertise because you're probably going to have expertise somewhere else.

So I think, you know, just to draw a box around it and say we want every director, whether they're elected or appointed, to look like this. I mean we may not get what we want. You want people who'll ask the questions and have the fiduciary responsibility and take the job serious. And, you know, they are there to do their job, represent their constituencies, but also they are there to make sure that that financial institution is successful.

And this Finance Board is to me that balancing act that comes in and says, you know, is management doing their job in terms of policies and procedures and is the Board doing their oversight of management and ensuring the objectives are met.

MR. NORRIS: May I just add to that? We're talking -- directing this to public interest directors and it ought to be to all directors because I had -- and there are seated directors on the Federal Home Loan Bank of Atlanta who are industry directors and they are public interest directors who know more than they do. They're more engaged in looking at that. So I don't think it's all the PIDs. It's all the directors in there.

CHAIRMAN KORSMO: Mr. Weicher?

COMMISSIONER WEICHER: That just feeds right in to what occurred to me as -- in the course of the testimony. About 20 years ago when I served on the Federal Savings & Loan Advisory Council and in that capacity -- of course, there was one member from each -- elected from each Bank. There was an elected director and there were a number of other people who -- from other -- through other capacities were serving on it who were directors of Home Loan Banks. And I met a lot of other directors. And they were all on the elective side.

Your last point, Mr. Norris, was right on target. I met a wide range -- very variable in quality. There were some directors who were very knowledgeable and astute and who I still found as good friends and whose insights I value 20 years later. And there were one or two who left me wondering what process led them to be chosen as members of the Boards of these important financial institutions.

I don't remember anybody reading the Wall Street Journal, but I remember one or two who might have benefited from reading the Wall Street Journal.

MR. HAYES: It was the comic section.

MR. MENDELOWITZ: No, in the Wall Street Journal, it's called the editorial page.

COMMISSIONER WEICHER: And I just, you know, there is a -- somehow out of this, there is a process which has, I think it was Mr. Ledford who was saying in the earlier panel, we can boast that we never lost a dime somehow out of this process. He wasn't treating that as praiseworthy. That isn't why I was asking the question, but out of this comes a process which has worked and survived some remarkable stresses over the 72-year history of the organization. Is there a way to do anything to improve the quality of directors on the elected side?

MR. NORRIS: My quick comment would be is the better educated the state and the members within that state are to the duties and responsibilities. It doesn't need to be a popularity contest. I wrote a letter to members in South Carolina focusing on all the issues, how important that is, directing them to look at their investment in the Federal Home Loan Bank. And to most members, the single largest asset on the balance sheet is your stock in the Federal Home Loan Bank System.

So again, calling that attention to it is -- look at your balance sheet now. Who's going to represent you on that? And we had five qualified candidates run this past year. Now, you know, when I ran the first time, it was a popularity contest. You know, because I had served as State Chairman of length, so the progression time. And I think that's changed. Now, I think that the more emphasis that is placed with the state and the members in there of how important that role is that things will change.

MR. HAYES: I think also, you know, a lot of us -- I'm thinking outside of this area -- get asked to serve on Boards and we say yes. But we may not always ask what are the responsibilities for saying yes. So maybe it is also part of this process to say, you know, if you are an elected director, you know, here is what you'll be expected to do. That may, you know, have some folks scared --

MR. NORRIS: Scared --

MR. HAYES: Scare them off, because I mean, I think we've all said yes and then, oh, what did I do? And then, you know, the other side, I mean, when you step back and Ed made the comment about our investments that we have in the stock, I mean, if that the person goes on the Board -- I mean, if he has the fiduciary responsibility, I mean, he's there and, you know, I think personally liable for those decisions. So, I mean, if they understand that when they have their Bank too. You know, it is good if they're multiple people running because at that point, you know, it is a good process.

But maybe education on the front side as we go through the nomination process and, you know, here's those responsibilities, so like education.

CHAIRMAN KORSMO: Director Leichter?

DIRECTOR LEICHTER: Yeah, let me direct a question to you, Ed. But let me first thank you really for the service that you've provided to the Federal Home Loan Bank System. It's been exceptional and it's been so many fold -- every time I look, there's Ed popping up in a new capacity, he's Chair of the Atlanta Bank, he's Chair of the ACB or the Federal Home Loan Bank Committee. He's on the Council and so on and all your services are really so distinguished, and I really appreciate your particular comments and insights. Very, very helpful.

Let me ask you, since particularly in your capacity as chair. How long on average would you say it takes a new director -- let's talk about public interest director -- to come to what you consider up to speed?

MR. NORRIS: Well, personally, when I went on the Bank Board eight years ago, it took me a year and a half to figure out what negative convexity was. Right now, what we're doing more is educating better. It came in and -- the cycle, because of the 18 members that Atlanta had, it's hard to stop and go through the orientation every year like that. So now, last year I laid that out. There was -- the majority, 80% of them had to be trained. You know, so it did emphasize. But with three new ones, you don't want to stop and do what we did last year the exhaustive -- the education process.

How long does it take a member -- a director to be -- to really participate? A year to two years. At the end of two years, they understand it pretty well. Now, Atlanta -- that was about nine meetings. When I came on, it was probably eleven. So it's dropped back some in there. So it's hard, unless you're continually looking at that. And we did -- we put things in place from the website and also as a continuing educational process. But that's one Bank and I don't know what the eleven other District Banks do.

So probably to answer yours, it's somewhere varying between -- I don't think anybody comes in as a new and picks it right up. I think it's going to basically take a year before they figure out what's going on.

DIRECTOR LEICHTER: All right. Ed, I think you've made an excellent suggestion, which is that we check with the Banks before we make our appointments to get some idea really what their needs are and that should certainly be part of the input, but listen, we've got a lot of good suggestions, and I don't know if we've ever seen them applied, but I would hope this one would be.

Let me also ask you, both not only as a Chair of the Atlanta Bank, but you're the Chair of your own Bank. Could you talk to us about what you consider as a Chair your role in working with your other Board members, keeping them informed, consultation, working with them. That's certainly an important part of governance, isn't it?

MR. NORRIS: Correct.

DIRECTOR LEICHTER: Would you talk some about it? Your experience, your suggestions to us on that?

MR. NORRIS: You recollect that there are similarities and in some ways, it's much easier from the community bank standpoint because you basically have them there. They understand what's going on in the community. The Federal Home Loan Bank is not just the Federal Home Loan Bank. It's the system. So I was in a unique situation in that it was daily in the system as well as the Bank.

There are some directors who really -- what's going on in the system is what they're told at the Board meetings. They don't know what's really the issues -- whether it may multi-districting or SEC registration or whatever those. But that's not bad a lot of times because the first I would say as a director, you need to look at the Bank. You need to understand the Federal Home Loan Bank of Atlanta or Topeka or Des Moines or San Francisco or whatever it might be. You need to understand the Bank. Then you can understand the system and all.

Communication regardless is extremely important. The directors have to know what they're working for. We were very fortunate in Atlanta in that putting together the three-year plan, is that we kept emphasizing, here's what we're doing for three years. You know, here's all the elements of it, whether it be MPP or MPF or advances or hedging strategies and derivatives -- all of that was encompassed in that three-year plan.

Now, is it going to the new ones next year or onto it. I can only hope it does that. But that is a problem in there is that once they're engaged in there, it's not constant enough so that they're continually looking at that. I think that's the responsibility of the individual District

Banks. I don't know anybody that can do that except the district Bank.

MR. HAYES: I think Ed makes an interesting analogy. I think as we run our Banks, you know, most of us in the community banks, you know, have a fairly defined market. I mean, it's easy to get your hands around that and you have directors who are involved in the community and have investments in your organization. And so their balancing act is, you know, I have a financial responsibility, I have a fiduciary responsibility, and I have a community responsibility.

And issues that I might deal with -- that ICBA in terms of, you know, what's going on are somewhat like the issues of Federal Home Loan Banks. They're not focused on that. And so their focus is on our institution and doing what we need to do to be successful in our communities.

I expect them to ask tough questions. Sometimes I wish they wouldn't, but I expect them to ask tough questions. I also expect them to be a counsel. When I have an issue that I need to discuss, that they are there to be able to discuss that in an open and professional manner with us. So I mean, I think there are a lot of similarities, but there are some that are not because just the scope -- it's a big organization. Ed ran as Chairman of the Atlanta Bank.

But it sounds to me like -- and just thinking that that three-year strategic plan, I mean, if that helped educate that group of directors because you had to go back and revisit some core issues. And I think when you revisit those core issues, everybody gets to a level playing field.

CHAIRMAN KORSMO: Director Mendelowitz?

DIRECTOR MENDELOWITZ: Thank you, Mr. Chairman.

I also want to thank you both for your contributions this morning and for the contributions of the organizations that you represent. ACB and ICBA have been very engaged and very involved in trying to help us understand the needs of your communities, the needs of the system, and how to tweak it to do a better job, and we really appreciate it.

And the fact that you both came today with very specific suggestions of things to consider is very helpful because you give us, not just an idea to chew over, but very specific things. I also want to add my appreciation to that expressed by Director Leichter to you, Ed, for your distinguished and committed service on the Board and in the leadership of the Board of the Atlanta Federal Home Loan Bank.

CHAIRMAN KORSMO: In fact, Ed, we have a plaque here that we'd like --

DIRECTOR MENDELOWITZ: And we do really appreciate that. I do have some questions I'd like to sort of work through. One of them goes to the issue of the rights of the member owners. Right now, member owners basically have two rights. They can vote for elected directors and they can receive dividends. Are there issues that should be decided by the members through their ability to vote on those issues, or should all the governance issues be resolved by the Boards of Directors of the Banks?

MR. NORRIS: That's a very interesting question. Number one, and I think, in the political process is that with South Carolina, for instance, we've got 90 members in there. You would get 90 different opinions if you ask all of them in there. So I think their involvement and engagement in electing a director who understands the community banking of the members -- the industry in that state.

So I guess just through the political process, I think if we make them more aware of the duties and responsibilities and how important the Federal Home Loan Bank System is -- a lot of them don't know it, even though they have a $4 million capital investment. They really don't know what the Federal Home Loan Bank System is. They know they can go and borrow advances if they need it, but that's basically the extent of it.

MR. HAYES: That's a tough balancing act. It's an interesting question because, I mean, if you do elect directors to represent the members, but I mean, it is the members that, in essence, have the equity involved. And I think if you went out and asked, as Ed said, 90 members in South Carolina or if you asked 205 in Tennessee, you might get 205 different answers.

But, you know, I think, you know, it's also important to ensure that there is an outreach to be able to get, you know, the thoughts -- thoughts and issues from the members and the association. And I think that's there, but probably can always be enhanced. And it's communication. So, I mean, it is -- it's tough for somebody to sit there and be the Chairman of the Federal Home Loan Bank. It’s also as a constant reminder to remember that there's a lot of members out there. You lack directors and I think that's a fair way to put it.

DIRECTOR MENDELOWITZ: Next, you raise the issue of considering eliminating public interest directors from the Boards. And when I think about that because it was raised in the context of possible change of Freddie and Fannie, I wonder whether the differences between those two GSEs and the Home Loan Banks make the parallel less instructive. And the reason why I'm raising that is that Freddie and Fannie are publicly-traded companies, have Boards of Directors who have a fiduciary responsibility to maximize shareholder value.

In a co-op like the Home Loan Banks where there is par value stock, there is no fiduciary responsibility to maximize shareholder value because shareholder value is always $100 a share. And secondly -- because you have different imperatives. Secondly, Home Loan Banks get certain advantages that Freddie and Fannie don't have. They don't pay federal income tax. And they have a very specific public policy objective. And one of the concerns -- it's -- one of the concerns I always have is that not just that the system be operated in a safe and sound way or that it actively fulfill the mission but the -- and I think the Chairman put it quite well when he described the summit of the impact of the first panel and this panel is that we have a balancing act. We have a balancing act of -- when it comes to public interest directors in terms of range of skills, and I think, Ed, you really described that beautifully, and I really think that that's really a nice way to describe it. But we also have a balancing act in terms of range of interest.

As the first panel pointed out, there are economic development, community development, affordable housing issues that the Banks are supposed to pursue. As both the Congressional Budget Office and the economists at the Fed have pointed out, all the GSEs receive significant subsidies because of their GSE status. And I worry that if you don't have public interest directors, the tendency will be for the members to capture more of those subsidies and the mission to get less of it.

And we sort of need the public interest directors to help ensure that the subsidies the system receives in fact are pushed towards serving the mission. Is that a legitimate concern on my part?

MR. NORRIS: I think so. Personally, I would never want just industry directors in there. I think on any Board whether it be Freddie, Fannie, Federal Home Loan Bank System, you're looking for a diverse Board with varying talents in there. So whether that's a public interest director recommended by the Finance Board or that the individual district Banks have a criteria for non-industry directors. I think that's very important. But I would not like to see the Board all bankers. I think you definitely have to go out into the housing and political and the different ones on there that bring those -- those fresh talents.

MR. HAYES: Our issue is to appoint them earlier so they get in the cycle.

DIRECTOR MENDELOWITZ: The next question goes to corporate governance in the very specific area. I see our Director of Supervision sitting there, and one of the important activities of the Finance Board is the annual supervision visits to the individual Banks, as well as the system-wide reviews that we're doing on what I would call high-risk areas like quality of corporate governance.

I'd like to get your views on what the appropriate role of a Board of Directors is in response to an examination report and the findings in the examination report.

MR. HAYES: Well, I’ve not sat in the chair Ed has sat in. [Laughter.] I'm making a big assumption here as it relates to when the examination report is filed that it is presented to the full Board of the Federal Home Loan Bank as it is within our Bank when we go through an examination, and if there are issues that are raised by safety and soundness compliance or information technology, we are required to respond to that and our Board is aware of that response and then I'm held accountable to doing those things that we committed to do.

So, I mean, if the Board has that ultimate oversight responsibility and to me, that's where the rubber meets the road. I've not sat across from the examiner --

MR. NORRIS: You have complimented me. I would compliment you on the hire of Steve Cross. Safety and soundness ought to be the focus in there and with the reports coming back to the Board and in eight years together, varying degrees of how much that report is presented in there. I thought the horizontal reviews were very helpful. In sitting down with the regulator, looking at, you know, where are the concerns and all in there. And we brought it back to the Board. We were very diligent in using that as suggestions or focus for the future and all.

So I commend you. I think as a stockholder in the system, not as a director, but as a stockholder in the system, I have to depend on my regulator -- the Federal Housing Finance Board -- to ensure the safety of my stock in the system. I cannot have it impaired. I've got an investment in there. I depend on that dividend, but I cannot risk having that stock impaired and my auditor making me write it down. I depend on this Board to ensure that. So the safety and soundness is very, very important.

CHAIRMAN KORSMO: But you also depend on the Board on which you serve to ensure that?

MR. NORRIS: Correct.

DIRECTOR MENDELOWITZ: What you're saying in effect is that it is the responsibility of the Board of Directors to respond promptly and with seriousness of intent to findings and issues raised in the exam report. And the Board that was dismissive or if not dismissive, certainly not positively and productively responsive to the findings of the supervision staff would be derelict in its duties?

MR. NORRIS: In my opinion, they would.

MR. HAYES: In my opinion --

DIRECTOR MENDELOWITZ: I don't want to lead the witness but --

MR. HAYES: And so would the CEO of that organization.

MR. NORRIS: But see, there are 12 unique Banks out there. Are you getting the same level, I don't know. Are the Boards engaged in the regulatory -- the audit reports? I don't know. I can tell you the Atlanta Bank is.

DIRECTOR MENDELOWITZ: I'm looking for the standard because to sum up my personal view is if our examiners have a problem, you have a problem. And to treat it any other way, I would consider problematic.

MR. HAYES: Not having said - in that as a director or whatever, but I mean, as the President or Director of our Bank, I mean, we may not necessary agree with the regulator, but they are the regulator and they are given a responsibility and then, you know, we can agree to disagree on an item, but, I mean, ultimately, the regulator, you know, the safety and soundness has a tremendous impact on our organization and what we can do during the report -- I mean, I would think that taking a safety and soundness report serious. I mean, I think that's of the utmost importance.

DIRECTOR MENDELOWITZ: So if there's a finding from the supervision staff, that's something that should be acted on promptly.

MR. NORRIS: Certainly.

MR. HAYES: Absolutely.

DIRECTOR MENDELOWITZ: I appreciate -- I hope Steve appreciates that --

MR. NORRIS: If that was leading. I hope we got to the right place.

CHAIRMAN KORSMO: Commissioner Weicher, did you have a --

COMMISSIONER WEICHER: I just want to add two things. One is listening particularly to Mr. Hayes, I was thinking where is James Madison when we need him. How do you balance the large members and the small members and we don't have a bicameral board anywhere along the line.

CHAIRMAN KORSMO: There was a time, of course, when the Boards of Directors of the Federal Home Loan Banks were elected by size.

COMMISSIONER WEICHER: There were tiers. We've moved away from that and it seems to me we moved away from it for good reason. I'm wondering if you all would -- you didn't exactly advocate a solution but -- that solution.

DIRECTOR MENDELOWITZ: There are two different solutions.

MR. HAYES: I think that at the point of saying, you know, X number of small, X number of large, I'm not sure that's a position that we're ready to deal with. I mean, we see today the process to be effective for community banks because if community banks decide that there is a community banker that they want to elect, I mean, if they can in fact get together. I mean, if they ran in five in South Carolina, I mean, it does run at risk. But if the balancing act of how the voting shares has enabled community bankers to be represented where in the past we were not. So, I mean, we really see no need today to change that.

MR. NORRIS: I would just add something to it. The largest members in there which, in Atlanta's situation certainly bar the most, you know, as far -- and in return have to have the most stock in there, the CEO's of those companies are not going to sit on the Board. They don't have time to do it. Now, do they appoint somebody down in their organization to do that? That would cause me some concern as a Chairman, as a CEO. I know where I need these and where my loans go and how the AMA programs and the whole intricacies of how I need the Federal Home Loan Bank System. I'm not sure that the Bank of America or the Wachovia are going to put the people who really know the whole aspect of it.

DIRECTOR CASTANEDA: Probably not.

MR. NORRIS: And so that's a problem in there. We have in Atlanta, for the first time, one of the larger, you know, we've always had the BB&Ts, but it's been because they bought somebody in that direction sitting on there. We had a director from AmSouth, which does have some expertise because he's dealing with derivatives on a daily basis. So there is some expertise to gain from the larger ones, but there's also the drawback in who serves on there.

So I don't have the solution to that either, but that basically is the problem.

CHAIRMAN KORSMO: Were you done?

COMMISSIONER WEICHER: I know something about one other question which is not necessarily related to this.

DIRECTOR MENDELOWITZ: All I wanted to know was just clarify something for the record. When I was stressing the importance of taking examination findings seriously, I didn't want either of the witnesses or anyone else to think that if you think supervision has it wrong on the merits, and you were to appeal a supervision finding to the Board which is a review body, that I or anybody else on the Board would not look at the issue on the merits and evaluate it on the merits and treat it fairly.

MR. NORRIS: I would just follow up. I got a handwritten note yesterday addressed to me. It didn't say Federal Home Loan Bank of Atlanta or Plantation Federal. It just says, I think you're spending too much money in financial recaps. Put it in dividends instead. You know, I think I'll send it to Ray Christman because -- I knew --

But, again, I think that's an attempt to keep the members engaged in seeing what happens when GAAP earnings are there and when you're trying to explain that, you get one that says, "I don't want to know that." Again, it's kind of that yours -- it's who really wants to know that and is it getting to the right people?

MR. HAYES: But, to your point. I mean, if some -- if a Bank disagreed with a finding, I mean, this Board would ultimately be the one that should review and discuss both with the examination staff and the Bank. You are the ultimate decider of that issue.

DIRECTOR MENDELOWITZ: I just didn't want you to think that the support for this issue would in any way compromise our impartial consideration of the issue.

CHAIRMAN KORSMO: John -- we'll listen and then we'll let Ed and Dave off the hook here.

COMMISSIONER WEICHER: I just wanted to ask the same question of you both that I asked of the last panel, which is that the system as a whole is an unusual thing in the American economy. We have a financial institution given certain special powers in order to serve a specific public purpose and expected in that process not to lose money in serving that purpose using those powers. And so it always becomes a balancing act of can you take more risk? Should you worry more about safety and soundness? And I wondered what you all think about the current balance. The other panel had addressed it.

MR. HAYES: Well, you address it because I'm going to head for home. I might come at it a different way.

COMMISSIONER WEICHER: We're about to go off.

MR. HAYES: Yeah. I am off and that's what I get for looking back on there.

I think we all sit everyday in our jobs and balance. And that balancing that we do today is not necessarily the balancing we did five years ago and won't be the same balancing we do five years from now. So I think we have a very successful system, very important to the members and it appears to be serving the public interest. So, I mean, you know, it's fundamentally doing what it's chartered to do.

And I think as members and investors, the vehicle there for us to be able to get advances to do the things that we need to do in our communities, loan money, make mortgages, I mean, it's paramount to our success and recognizing that there are unique opportunities that are both political and environmental that are going on. I mean, overall I feel comfortable with the system.

MR. NORRIS: And my comments would not be as Chairman of the Atlanta Bank or a director of the Bank, but as a stockholding member of the system. There is no doubt in my mind that the most strategic ally that I have as a community bank is the Federal Home Loan Bank System. On my balance sheet, my operations is I can replace bankers, I can get more capital. I can't replace the Federal Home Loan

Bank. So in weighing the risk and this is one thing that I always do, I'll give up my dividend, you know, I'll cut it down. Don't put risk in there to anything that would force me to lose the Federal Home Loan Bank System.

Community banks have to have that. We don't have the advantages of Wall Street on the liquidity side. And one thing, you're safety and soundness for me the member in there. Asset liability for a community bank, being able to structure advances and use it for asset liability is safety and soundness, for me the member in there. So mine is that I've had the system. I have to know that the system is protected in there. So mine is don't inject more risks if it would cause me to lose the system.

DIRECTOR CASTANEDA: Mr. Chairman, I think we always have to invite Mr. Norris to our meetings.

CHAIRMAN KORSMO: He thinks that too.

MR. NORRIS: I'm passionate, too.

CHAIRMAN KORSMO: Ed, Dave -- Ed Norris, Dave Hayes, Carol Wayman, Dave Ledford, Bob Broeksmit, thank you very much for your input. We appreciate it. It's been very valuable.

DIRECTOR LEICHTER: Let me add my thanks and also thanks for both your organizations.

CHAIRMAN KORSMO: Absolutely.

DIRECTOR LEICHTER: It's really been important to the Home Loan Bank System, showing us things that need to be done and so on and we listened.

CHAIRMAN KORSMO: This discussion is an ongoing one. Obviously, your two organizations and the three that served on the previous panel are people we take -- organizations whose input we take very seriously. We appreciate your time today and we look forward to this discussion going on.

As I noted at the outset of the session, we will have a second round of this hearing on February 10th. We will be hearing at that time from a couple of outside "experts" who will provide some input on board governance as a general topic, and to the extent they can, specifically address those general concepts to the governance of the Federal Home Loan Banks and we're also hoping for additional comments from some of Ed's compatriots who have served as Chairs and Vice-Chairs and Directors of the 12 Banks.

So again, thank you very much to our panelists today. We appreciate it, and this hearing is adjourned.

(Whereupon, at 12:41 p.m., the hearing was adjourned.)