FEDERAL HOUSING FINANCE BOARD

Building Blocks

Volume 8 No. 2
Winter 1999

table of contents

Public Comment Sought

Proposal Approved To Restructure FHLBanks' Office of Finance

On December 14, 1999, the Federal Housing Finance Board approved a proposal that would restructure the Federal Home Loan Banks' Office of Finance (OF) and broaden its duties and responsibilities, consistent with the Finance Board's goals and Congressional mandates to increase the business autonomy of the FHLBanks.

The proposed rule is designed to facilitate the issuance, through the OF, of FHLBank consolidated obligations (COs) and thereby give the FHLBanks more flexibility in managing their own business activities. The rule would also authorize the OF to serve as a central facility that two or more FHLBanks could choose to use to assist them in managing joint asset activities such as Member Mortgage Assets programs.

"This proposed rule aims to promote efficiency in achieving the housing finance and community development mission of the FHLBanks," said Finance Board Chairman Bruce A. Morrison. "By creating a new structure for the Office of Finance, it will enable the FHLBanks to better meet new challenges faced by the System. The nationalized mortgage market has created a need for a facility that will give the FHLBanks the option of centralizing many of their common business functions."

The FHLBanks are financed principally by proceeds from COs that are currently issued through the OF as agent for the Finance Board. Under the proposed rule, the OF would issue the COs as agent for the FHLBanks, which would continue to be jointly and severally liable for the COs.

Removing the Finance Board as the debt issuer would eliminate possible conflicts with its role as regulator of the OF and the FHLBanks, and would limit the potential for U. S. Government liability. Aside from these advantages, this change would not effect the FHLBank System's debt issuance process in any substantive way.

Under the reorganization, COs will be issued as the joint debt of the 12 FHLBanks. Also, the proposed rule calls for the OF to prepare the combined financial reports of the FHLBank System and to continue to prepare the offering documents that facilitate CO issuance.

The proposed rule would incorporate into regulation

(See **CHANGES**, page 2)

Finance Board Takes Action To Improve FHLBanks' Autonomy

The Federal Housing Finance Board approved on December 14 a set of measures designed to devolve corporate governance responsibilities to the boards of the FHLBanks and provide a framework for their new responsibilities.

The Finance Board approved an interim final rule, a proposed rule, and a resolution, each of which deals with various issues involving FHLBank directors and their responsibilities. These actions mark the beginning of the regulatory agenda laid out by the Finance Board to implement the FHLBank provisions of the Gramm-Leach-Bliley Act, signed into law by President Clinton on November 12, 1999. (See tentative schedule on page 5.)

"These actions are an expedited response by the Finance Board in implementing the recently enacted FHLBank modernization legislation.

(See **ACTIONS**, page 3)

(**CHANGES,** from page 1)

uniform disclosure standards that are currently set forth in a Finance Board policy statement. It would require that the annual and quarterly combined FHLBank System financial reports be prepared in a manner consistent with the disclosure requirements of the Securities and Exchange Commission, with certain listed exceptions. The Finance Board will continue to oversee the combined FHLBank System financial reports for compliance with the applicable disclosure standards.

The Finance Board anticipates that the need for a central facility will increase as joint asset activities such as Member Mortgage Assets programs represent a greater percentage of the Banks' core business.

"If the FHLBanks have more flexibility to carry out joint asset activities which help them compete in the national mortgage market," said Chairman Morrison, "then FHLBank members will also benefit, ultimately leading to lower costs for homeowners."

The Finance Board also proposes to alter the size and composition of the OF's Board of Directors to reflect its additional functions, and to provide enhanced management experience and broader Bank and member representation. The existing OF board of directors consists of two FHLBank presidents and one public interest director because the functions of the OF have been limited to issuing debt as agent for the Finance Board. The proposal would expand the OF Board to 24 members: 12 appointed by the FHLBanks, 6 elected by FHLBank members, and 6 appointed by the Finance Board, to ensure that each FHLBank, the industry, and the general public would be fully represented on the board. The Finance Board acknowledges that the size of the proposed OF Board may seem unwieldy, and is soliciting suggestions for alternative structures.

The proposed rule will have a 60-day comment period upon publication in the Federal Register. Written comments should be sent to Elaine Baker, Secretary to the Board, Federal Housing Finance Board, 1777 F Street NW, Washington D. C. 20006.

The complete text of the proposed rule is on the agency's web site at www.fhfb.gov. Click on "What's New," click on "FHFB approves proposal to expand, restructure FHLBanks' Office of Finance."

Office of Finance Restructuring

Questions and Answers

What is the Office of Finance?

The Office of Finance is the only joint office of the FHLBanks. Its role is to exclusively offer and service the consolidated obligations (bonds and discount notes) of the 12 FHLBanks. These consolidated obligations, on which the FHLBanks are jointly and severally liable, are the primary funding source for the FHLBanks. Established in 1972 and now located in Reston, Virginia, the Office of Finance has a three-person board of directors (two FHLBank presidents and one private citizen) and fewer than 50 employees. As of September 30, 1999, the FHLBanks had outstanding consolidated obligations of more than $477 billion.

How would the proposal restructure the Office of Finance?

The proposal, if adopted, would make three changes in the operations of the Office of Finance. First, instead of the Finance Board issuing debt for the FHLBanks through the Office of Finance, the FHLBanks themselves would issue their own joint debt through the Office of Finance. Also, as part of the debt-issuance function, the Office of Finance would be responsible for the preparation of the FHLBank System's combined quarterly and annual financial reports. The Finance Board has been preparing these reports.

Second, at the request of two or more FHLBanks, the Office of Finance would administer or service certain joint FHLBank asset activities.

Third, the proposal would make organizational changes to the Office of Finance, principally by restructuring its board of directors to accommodate its increased functions and responsibilities.

How would the proposal change the FHLBank bonds and discount notes?

The changes would be largely technical. At the present time, the Finance Board issues the consolidated obligations of the FHLBanks through the Office of Finance under Section 11(c) of the Federal Home Loan Bank Act. If adopted, the proposal would authorize the FHLBanks to issue joint debt, which would also be called consolidated obligations, in their own name through the Office of Finance under Section 11(a) of the Act.

As is now the case by statute, all of the FHLBanks would, by regulation, be jointly and severally liable for consolidated obligations jointly issued by the FHLBanks. The proposal makes it clear that the joint-and-several liability provisions of the Finance Board's regulations apply to Section 11(a) debt as well as to Section 11(c) debt. As is now the case, no FHLBank would be permitted to issue individual debt under Section 11(a). The proposal provides the exclusive list of other liabilities that a FHLBank may incur.

Why is the Finance Board proposing to change the way

(See **Q AND A**, page 4)

(**ACTIONS**, from page 1)

They will empower the FHLBanks to run their own affairs in a safe and sound manner while carrying out their housing finance and community lending mission," said Finance Board Chairman Bruce A. Morrison. "In addition, they are designed to enhance the ability of the FHLBanks to develop new mission-related credit products for their members as they move to shift their balance sheets toward value-added, member-related assets."

The Gramm-Leach-Bliley Act removes the last vestiges of governance responsibilities from the Finance Board, giving the FHLBanks responsibility over corporate functions that previously required Finance Board approval. The Finance Board, of course, retains its fundamental regulatory responsibility for ensuring that FHLBanks operate in a safe and sound manner and carry out their statutory housing and community-lending mission. Thus, the proposed rule approved by the Finance Board on December 14 lays out a state-of-the-art corporate governance framework as it defines the responsibilities of the boards of directors and senior management of the FHLBanks.

Among the changes mandated by the new legislation are limits on the annual compensation paid to FHLBank directors. Starting in 2000 and subject to adjustments each year in accordance with the limits set forth in the legislation, the interim final rule limits FHLBank annual compensation for board chairs to $25,000, for vice chairs to $20,000, and for other board members to $15,000. While these limits are less than the existing compensation for many board members, Congress intended that no diminution in workload would result as a consequence of the reduced compensation**.**

Accordingly, for safety and soundness reasons, the interim final rule requires that each FHLBank's board continue to maintain its level of oversight of the management of the FHLBank. Consistent with this maintenance of effort standard, the interim final rule requires each FHLBank's board to hold no fewer in-person meetings in any year than it has held on average over the immediately preceding three years. But a FHLBank may apply to the Finance Board for approval, upon a showing of good cause, to hold less than the required number of in-person board meetings in any year.

In addition, and consistent with Congressional intent, the Finance Board believes that directors should be compensated only for the performance of official FHLBank business and not simply for holding office. Accordingly, the interim final rule provides that, starting in 2000, a FHLBank may not pay fees to a director, such as retainer fees, that do not necessarily reflect actual performance by the director of official FHLBank business. Thus a director who regularly fails to attend board or committee meetings may not be paid at all, and the Finance Board would consider such failure a dereliction of the director's fiduciary duties that would constitute cause for removal of the director under the Federal Home Loan Bank Act.

> *"In addition, [the changes] are designed to enhance the ability of the FHLBanks to develop new mission-related credit products for their members as they move to shift their balance sheets toward value-added, member-related assets."*
>
> Bruce A. Morrison
> Finance Board Chairman

Other changes in the governance responsibilities made by the Modernization Act are the removal of the requirement for Finance Board approval in connection with: the selection and compensation of FHLBank officers and employees; FHLBank building transactions; FHLBank budgets; FHLBank bylaws; FHLBank dividends; FHLBank forms for advances applications, advances agreements and security agreements; FHLBank conditional advances; and FHLBank transfers of advances and advance participations. The interim final rule removes the Finance Board approval provisions with respect to these matters from the Finance Board's regulations.

The proposed rule establishes a number of requirements for the FHLBanks to ensure that they carry out their governance responsibilities in a safe and sound manner. These include: the adoption and annual review of risk management policies, periodic risk assessments, maintaining effective internal controls, the establishment of independent audit committees and adoption of and compliance with a strategic business plan.

Both the interim final rule and the proposed rule will have a 30-day public comment period, upon publication in the Federal Register.

The Board also approved a resolution that determines how provisions in the legislation regarding the terms of office and election of FHLBank directors will be implemented. The legislation established three-year terms of office for all FHLBank director positions, both appointed and elected, and had the effect of lengthening for one year the two-year terms for current elected directors and shortening by one year the four-year terms for current appointed directors.

The interim final rule is effective upon its publication in the Federal Register on December 21. The interim final rule provides for a 30-day comment period. Comments should be mailed to Elaine L. Baker, Secretary to the Board, Federal Housing Finance Board, 1777 F Street N.W., Washington D.C. 20006.

The interim final rule is on the Finance Board's web site at "What's New," click on "FHFB takes actions to increase FHLBanks' autonomy."

(**Q AND A**, from page 2)

FHLBank consolidated obligations are issued?

The Finance Board is the safety-and-soundness regulator for the FHLBanks. The Finance Board has long believed that its should not be involved in the process of providing the primary source of funds for the operations of the entities it regulates.

This view is consistent with recent Congressional mandates intended to remove the Finance Board from involvement in the business decisions of the FHLBanks. The Office of Federal Housing Enterprise Oversight (OFHEO), which is the safety-and-soundness regulator of Fannie Mae and Freddie Mac, does not issue their debt, nor does the Office of the Comptroller of the Currency issue the debt for national banks. The proposal will end this FHLBank System anomaly.

Does the proposal make changes to the System's leverage limit?

The Finance Board's regulations prohibit the issuance of consolidated obligations if such issuance would bring the FHLBank System's consolidated obligations and other unsecured senior liabilities (principally deposits) above 20 times FHLBank System capital. The Finance Board's Financial Management Policy also applies this limit on a FHLBank-by-FHLBank basis.

The proposal would delete the FHLBank System-wide leverage limit from the regulations and replace the 5 percent FHLBank-by-FHLBank liability-based leverage limit with a 4.76 percent leverage limit based on assets. These two limits are mathematically identical.

The imposition of this standard on each FHLBank will ensure that the FHLBank System itself stays within the leverage limit, rendering the retention of a FHLBank System-wide leverage limit unnecessary. The proposal, however, removes the Office of Finance from leverage monitoring because monitoring regulatory compliance is more properly a function of the Finance Board.

What other changes would the proposal make to the debt issuance process?

The proposal would eliminate from the Funding Guidelines in the Financial Management Policy specific debt-issuance parameters. Instead, the board of directors of the Office of Finance would be responsible for setting the terms and conditions of the debt and for establishing prudent risk-management practices and prudential debt parameters, while taking into account the role of the FHLBanks as government-sponsored enterprises, the cooperative nature of the FHLBank System, and investor suitability standards. This would largely entail the Office of Finance codifying its existing practices, subject to Finance Board oversight and supervision.

For more information on this issue, go to the Finance Board web site at www.fhfb.gov and click on "What's New."

Why is the Finance Board proposing to allow the FHLBanks to use the Office of Finance as a vehicle to assist them in their joint asset activities?

The proposal would require the Office of Finance to provide administrative and technical support for the origination, management, servicing, or sale of assets at the request of two or more FHLBanks. The proposal does not require FHLBanks to use the Office of Finance for these services, but it does require the Office of Finance to provide these services, on a contractual or reimbursable basis, if two or more FHLBanks request them.

The Office of Finance is the only statutorily recognized joint office of the FHLBanks, thus it is the only potential place to house joint asset-management activities. For purposes of the proposal, the Finance Board anticipates that the FHLBanks might seek to use the services of the Office of Finance to provide the "back room" functions associated with the purchase of mortgage assets by the FHLBanks. In the development of these mortgage purchase programs by the FHLBanks, the Finance Board wants to enable market evolution that may entail more centralized management of these programs. As the barriers to national operations by depository institutions continue to erode, these institutions may prefer to deal with national instead of regional asset programs of the FHLBanks.

What changes is the Finance Board proposing for the board of directors of the Office of Finance?

The proposal would expand the Office of Finance board of directors to 24 persons. The Finance Board believes it is important for each FHLBank to be represented on this board because the Office of Finance provides all the bond and discount note financing for each FHLBank.

Because the Office of Finance under this proposal could also be involved with the administration of joint asset activities of the FHLBanks, the proposed board would include six directors elected by members, who are the ultimate users of the FHLBank System, and six directors appointed by the Finance Board.

When would the changes be effective?

The proposed regulation will be published for a 60-day comment period in the Federal Register. If after reviewing all the comments the Finance Board decides to publish a final rule, the new board structure would not take effect until 2001. However, if adopted, the FHLBanks would be responsible for issuing joint consolidated obligations in their own name no later than December 31, 2000. After this date, the Finance Board would no longer issue consolidated obligations for the FHLBanks.

TENTATIVE SCHEDULE FOR PROPOSED REGULATIONS

The following chart was prepared by the Finance Board staff to identify the types of regulations required by the Gramm-Leach-Bliley Act and to estimate the dates when those regulations will be presented to the Finance Board's directors. All dates are tentative and subject to prior consultation with the House and Senate Banking Committees.

TYPE OF REGULATION	DATE
1. Regulations concerning corporate governance of the FHLBanks.	
A. Powers and responsibilities of FHLBank boards and senior management.	December, 1999
B Amendments to and deletions of existing Finance Board regulations and policies concerning Finance Board approval of certain FHLBank management functions eliminated by the legislation, including Finance Board approval of FHLBank dividends, employee compensation, budgets, bylaws, building purchase or lease.	December 1999
C. Restructuring of Office of Finance.	December 1999
D. Amendments to elections regulation to adjust terms of elected directors, institute a staggered board.	February 2000
2. Regulations Concerning Powers of the FHLBanks	
A. Amend REFCorp regulations to reflect Finance Board's annual obligation to select appropriate present value factors, in consultation with the Secretary of the Treasury, for determining the extent to which the value of the aggregate amounts paid by the FHLBanks exceeds or falls short of the value of an annuity of $300 million per year.	January 2000
B. Amend membership regulations to reflect completely voluntary nature of membership, clarify conditions of withdrawal, reflect changed lockout period, define community financial institutions, exempt CFIs from the 10 percent of real-estate related assets requirement for membership, eliminate provisions giving non-QTL members less favorable access to the FHLBank System.	February 2000
C. Safety and soundness modifications to the Financial Management Policy.	February 2000
D. Amend advances regulations to define small business, small farm, small agribusiness, and secured loans.	March 2000
E. Definitions of mission and mission-related assets, authorization of FHLBank investments in Member Mortgage Assets and targeted equities.	March 2000
F. Amend advances regulations to establish review standards for new collateral, and for the removal of the 30 percent cap on "other real-estate related collateral."	March 2000
3. Regulations Concerning the Capital Structure of the FHLBanks	
A. Capital rules (including a stress test) to replace existing subscription capital structure with a risk based, more permanent capital structure.	May 2000
4. Mission Achievement Standards	
A. Mission achievement standards	2001

New FHLBank Directors Named; Terms Began January 1

The following individuals were appointed as a community interest director of the Federal Home Loan Bank indicated below, each for a three-year term beginning January 1, 2000, except as noted. The appointments are subject to the review by the Finance Board of each individual's Appointive Director Eligibility Certification Form and will become effective upon confirmation of their eligibility by the Managing Director

Federal Home Loan Bank of Boston
Patrick Dober
Kathleen N. Sullivan
Marc Pacheco
Ronald L. Phillips who is currently serving as an appointive director is designated a community interest director for the remainder of his appointment that expires December 31, 2001

Federal Home Loan Bank of New York
Joseph Crangle
Derek B. Park

Federal Home Loan Bank of Pittsburgh
Sarah E. Peck

Federal Home Loan Bank of Atlanta
Barton F. Harvey, III
H. Daniel Pincus, a one-year term beginning January 1, 2000

Federal Home Loan Bank of Cincinnati
Margaret L. Behm

Federal Home Loan Bank of Indianapolis
Pamela Martin Turner
Dennis J. West (cid)

Federal Home Loan Bank of Chicago
Karl Pnazek
Leslie Ann Howard (cid)

Federal Home Loan Bank of Des Moines
Marjorie A. Anderson
Cecelia A. Grunewaldt
William M. Washington

Federal Home Loan Bank of Dallas
Lauren Anderson
Bradford J. Dye, Jr.
Betsy Wright

Federal Home Loan Bank of Topeka
David H. Herlinger (CID)
David K. Karnes

Federal Home Loan Bank of San Francisco
Daniel Ortega, Jr.
Roberta Achtenberg

Federal Home Loan Bank of Seattle
Les AuCoin
Maxine Fitzpatrick
Stephen M. Studdert

FHLBanks' Community Investment Officers

Each Federal Home Loan Bank has a Community Investment Officer (CIO) to assist organizations seeking information on community development efforts in the FHLBank's district. The 12 CIOs and their telephone numbers are:

Federal Home Loan Bank of Boston
David Parish 617-330-9872

Federal Home Loan Bank of New York
Joseph Gallo 212-441-6824

Federal Home Loan Bank of Pittsburgh
John Bendel 412-288-2820

Federal Home Loan Bank of Atlanta
Robert Warwick 404-888-8435

Federal Home Loan Bank of Cincinnati
Carol M. Peterson 513-852-7615

Federal Home Loan Bank of Indianapolis
Frederick Hash 317-465-0428

Federal Home Loan Bank of Chicago
Michael Liu 312-565-5705

Federal Home Loan Bank of Des Moines
Curt Heidt 515-281-1175

Federal Home Loan Bank of Dallas
Criss D. Murdoch 214-944-8636

Federal Home Loan Bank of Topeka
Christ J. Imming 785-233-0507

Federal Home Loan Bank of San Francisco
James Yacenda 714-633-1271

Federal Home Loan Bank of Seattle
Judith C. Dailey 206-340-8708

Building Blocks is published quarterly by the Federal Housing Finance Board, Office of Public Affairs, 1777 F Street, Washington, DC 20006. The telephone number is (202) 408-2810 and the email address is *mcgeed@fhfb.gov*.

Chairman
Bruce A. Morrison

Editor/Writer
Dennis O. McGee