

---

FEDERAL HOUSING FINANCE BOARD  
HEARING ON  
CORPORATE GOVERNANCE OF THE FEDERAL HOME LOAN BANKS

TESTIMONY OF

ROBERT N. BARONE  
CHAIRMAN OF THE BOARD OF DIRECTORS  
FEDERAL HOME LOAN BANK OF SAN FRANCISCO

ON BEHALF OF THE  
FEDERAL HOME LOAN BANK OF SAN FRANCISCO

FEBRUARY 10, 2004

---

## I. Introduction

The Board of Directors of the Federal Home Loan Bank of San Francisco shares the view of the Federal Housing Finance Board that effective corporate governance is critical to the ability of the Federal Home Loan Banks to achieve their mission.

At this time, the San Francisco Bank has the following recommendations to enhance the corporate governance of the Federal Home Loan Banks.

## II. Recommendations

### A. Member Rights

The Finance Board and the members, directors and management of the Federal Home Loan Banks should engage in a comprehensive review of the statutory and regulatory rights of members as shareholders, specifically addressing whether members should be required or permitted to vote on corporate matters other than director elections. These matters could include director compensation, capital plan amendments, merger approvals, or any of the other rights generally afforded to the shareholders of state-chartered corporations, as long as they are consistent with the public purpose and mission of the Federal Home Loan Banks and their organization as mutual enterprises (where the shareholders form the customer base).

### B. Director Qualifications

The extraordinary growth of the Federal Home Loan Bank System over the past ten years reflects the growth of the housing finance industry and its importance as a driver of the national economy. Ensuring the safety and soundness of the Federal Home Loan Banks is more vital now, and a more demanding task, than ever before.

Although the primary mission of the Federal Home Loan Banks - making advances to support housing lenders - has not changed, the Federal Home Loan Banks operate in an increasingly complex environment, with a myriad of internal and external challenges and opportunities. The spreads on the basic business are narrower, the products more complex, the competition more fierce, the accounting and legal rules more uncertain, and the opportunities for financial missteps more pronounced.

The San Francisco Bank believes that because of all these factors, the Federal Home Loan Banks require directors who have both the capability and the

dedication to discharge their oversight responsibilities. The San Francisco Bank believes that the current mix of appointed and elected directors enhances the ability of the San Francisco Bank to achieve its mission. Setting a high standard for the qualifications of Federal Home Loan Bank directors will ensure that they are able to exercise independent business judgments on the important issues they face.

The San Francisco Bank recently considered the importance of setting high standards for directors when it adopted procedures for the selection of a new director to fill any vacant elected directorship (a statutory responsibility of the board). The procedures specify that in nominating and voting for any candidate for a vacant directorship, the directors will consider the qualifications they deem relevant, which may include the candidate's prior board service; relevant experience relating to the business of the Bank; demonstrated interest in and understanding of the business of the Bank and the Federal Home Loan Bank System; other business and financial experience, knowledge, skills and judgment; and the ability to participate fully in the activities and responsibilities of the board. The Finance Board should consider these types of qualifications in setting standards for the directors of the Federal Home Loan Banks.

#### C. Director Terms

All corporate boards evolve over time, as new directors join and experienced directors depart. But the challenge of assimilating new directors and facing the loss of experienced directors is especially difficult in a highly specialized institution like a Federal Home Loan Bank. Even individuals with extensive experience in other financial services institutions can take many months or even years to comfortably grasp the intricacies of the Federal Home Loan Bank System. It is true that new members can invigorate a board by bringing fresh ideas and prompting the board and management to revisit fundamentals, but the high level of turnover on the boards of some of the Federal Home Loan Banks has not left them well-equipped to handle the most difficult challenges.

To provide greater continuity on the boards of the Federal Home Loan Banks and a better balance between new and experienced directors, the terms of all directors (appointed and elected) should be extended from three years to four.

#### D. Director Compensation

In 2004, the compensation of Federal Home Loan Bank directors is limited to \$27,405 for the board chair, \$21,924 for the board vice chair, and \$16,443 for other board members.

First, it seems difficult to justify statutorily fixed annual compensation limits that increase only according to annual increases in the consumer price index, given that the responsibilities and demands placed on Federal Home Loan Bank directors can change (and have changed) dramatically over time. Second, the statutory limits do not even come close to allowing a fair market level of compensation for Federal Home Loan Bank directors, given their extraordinary responsibilities and the demands placed on them.

To provide for the fair compensation of Federal Home Loan Bank directors commensurate with their duties and responsibilities, the statutory compensation limits should be removed. Instead, the board of each Federal Home Loan Bank should be permitted to set its own compensation, subject to safety and soundness oversight by the Finance Board (and possibly subject to the approval of members, in accordance with the member rights review discussed above).

#### E. Joint and Several Liability

The Federal Home Loan Bank System is unique in that there are twelve corporate entities that share joint and several liability for all of the debt issued for the benefit of each of the Federal Home Loan Banks. The San Francisco Bank believes that enhanced information sharing among the Federal Home Loan Banks, beyond the level of information typically made available through Securities and Exchange Commission-type disclosures, would enhance the safety and soundness of the System. This information sharing should be administered by the Finance Board.

### III. Future Developments

The San Francisco Bank appreciates the opportunity to provide these recommendations to the Finance Board at this time. Given the complexity and significance of the governance of the Federal Home Loan Banks and the continuing development of best practices in corporate governance generally, the San Francisco Bank looks forward to providing additional recommendations and input to the Finance Board on these and other related topics.