

**BEFORE THE
FEDERAL HOUSING FINANCE BOARD**

TESTIMONY OF

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**ON BEHALF OF THE
FEDERAL HOME LOAN BANKS**

DECEMBER 2, 2002

1. INTRODUCTION

Mr. Chairman, Directors and staff of the Federal Housing Finance Board (“Finance Board”), it is our distinct pleasure to submit this testimony on behalf of all twelve Federal Home Loan Banks (“FHLBanks”) regarding the views of the FHLBanks concerning registration of FHLBank stock under the Securities Exchange Act of 1934 (“1934 Act”).¹

To begin with, the FHLBanks continue to support full, accurate and completely transparent securities disclosure. The FHLBanks have and will continue to ensure that the FHLBank System adheres to the best possible disclosure standards.

Within this framework, however, the FHLBanks can identify no public policy reason to transfer jurisdiction over securities issued by the FHLBank System and the FHLBanks from the Finance Board to the Securities and Exchange Commission (“SEC”). Neither FHLBank members nor the financial markets are seeking SEC registration of FHLBank capital stock. Moreover, the SEC public company model does not accommodate the cooperatively-owned FHLBank System, particularly in light of the joint and several liability for Consolidated Obligations (“COs”) that the twelve FHLBanks bear as a matter of law. Neither the SEC model nor the FHLBank System constructed by Congress can or should be restructured to create that accommodation.

Nevertheless, the FHLBanks have and will continue to make enhancements to the disclosure regime under which they operate. In that regard, we offer the following specific recommendations for an enhanced securities disclosure:

¹ A number of the FHLBanks are also submitting their own individual testimony for consideration by the Finance Board.

(i) The Finance Board should modify and improve as necessary its rules on FHLBank and FHLBank System reporting and disclosure to capture all necessary and appropriate disclosure requirements of the 1934 Act and underscore the importance of accountability and fulsome disclosure to FHLBank System investors and FHLBank members.

(ii) The Finance Board should adopt new regulations that would impose state-of-the-art securities disclosure standards for mortgage-backed securities, when and if they are authorized, which will provide a model for all government-sponsored enterprises (“GSEs”);

(iii) The Finance Board, along with the Office of Finance (“OF”), should continue to review its disclosure practices and make appropriate changes, so that offering disclosures conform to SEC disclosure requirements; and

(iv) The Finance Board should coordinate its comprehensive supervision of the FHLBank System with the administration of this newly-tailored disclosure regime to foster the dissemination of meaningful, material and transparent information to investors and members, and to promote taxpayer confidence in a safe and sound FHLBank System.

In this context, however, we must emphasize that, in our view, the Finance Board is in the best position, both as a matter of law and supervision, to assure, as it has done in the past, the timeliness, accuracy and completeness of FHLBank and FHLBank System disclosures. Congress created the Finance Board and the FHLBank System so that the Finance Board would always have intimate knowledge of the business and financial

condition of each of the twelve FHLBanks through its supervision of the FHLBank System. The FHLBank System has worked well for more than 70 years, playing a key role in putting millions of Americans in homes.

Let there be no mistake: while the FHLBanks have the greatest of respect for the ability and expertise of the SEC, having it assume a dominant role in the supervision of the FHLBanks through authority over their disclosures would represent a fundamental change in the regulatory regime of the FHLBank System, one that in turn could result in fundamental, and potentially adverse changes in the ability of the FHLBank System to meet the needs of its member owners and the communities that they serve. Therefore, while the FHLBanks support an enhanced disclosure regime, this regime should continue to be administered by the Finance Board.

**2. THE FHLBANK SYSTEM IS A UNIQUE SYSTEM
CREATED BY CONGRESS TO SERVE
THE INTEREST OF ITS MEMBER OWNERS
AND THEIR COMMUNITIES**

The FHLBank System is truly unique in its structure and operation. It was created by Congress in 1932 by the Federal Home Loan Bank Act (“FHLBank Act”)² to provide wholesale mortgage finance through independent, cooperatively-owned FHLBanks. Each FHLBank independently manages and controls its own business activities, operations and financial performance. The twelve FHLBanks are required by law, however, to jointly fund their operations through the issuance of COs, for which they are jointly and severally liable.³ As a result, the FHLBanks operate separately, but are

² 12 U.S.C. §§ 1421-1449.

³ The FHLBank System is one of the largest issuers of debt in the world. As of September 30, 2002, it had approximately \$667.6 billion in COs outstanding.

financially linked. This is a unique and critical factor that affects how the FHLBank System operates, how it should be regulated, and how disclosure must be effected. Thus, while each FHLBank and its management is able and willing to issue SEC-like disclosures with regard to its own capital stock, no one FHLBank or FHLBank CEO or CFO can speak for the FHLBank System, or for CO disclosures. The COs trade successfully in the capital markets based on combined disclosures made by the FHLBank System, which, until very recently, have been the responsibility of the Finance Board itself.⁴

Furthermore, the capital stock of each FHLBank is entirely a creation of statute⁵ and is 100%-owned by the FHLBank System's almost 8,000 member financial institutions, which range from small community financial institutions to the nation's largest depository institutions. Unlike other housing GSEs, the FHLBanks are cooperatives. A member joins a FHLBank and becomes a stockholder so that it can obtain the benefits of membership, not to subject itself to the rewards and risks of investing. The structure of the FHLBank System and its individual FHLBanks is different from the normal public company model, because of the cooperative nature of the FHLBank System. The goal of the business of an FHLBank is not to maximize profit on each transaction in order to reward its stockholders. Instead, the goal of an FHLBank is to create financial products that allow the members to maximize their ability to provide competitively priced home mortgage products to American homebuyers.

⁴ Office of Finance; Authority of Federal Home Loan Banks To Issue Consolidated Obligations, 65 Fed. Reg. 36290 (2000) ("Office of Finance Regulation"). See also Offering Circular, Federal Home Loan Banks, Consolidated Bonds and Consolidated Discount Notes; Information Memorandum, Federal Home Loan Banks, Global Debt Program.

⁵ 12 U.S.C. § 1426.

The FHLBanks do not have the authority to issue common stock to public shareholders. The capital stock that they issue to their members does not trade on any stock exchange or the NASDAQ. Federal law and Finance Board regulations dictate the nature, duration and par value of FHLBank capital stock.⁶ FHLBank capital stock is transferable only between member institutions, and, in any event, may never be transferred to or held by the general public. It is not comparable to stock issued by a public company. It may be issued, transferred, repurchased and redeemed only at par. Moreover, unlike the stock of some of the other GSEs, no officer or director of any FHLBank may own any FHLBank stock or stock options, receive other equity-linked compensation, or otherwise benefit financially from the stock.

Not only is each FHLBank a cooperative enterprise with its own members, but the FHLBanks' joint and several liability for COs creates a structure in which all of the individually-operated FHLBanks are engaged in a common cooperative enterprise as to which public company registration and disclosure conventions cannot be easily applied. The OF, a joint office of the FHLBank System, which was expressly preserved by Congress in the Financial Institutions Reform, Recovery and Enforcement Act of 1989 ("FIRREA"), prepares all disclosure materials for the FHLBank System and has no counterpart in the private sector. In recognition of this unique financing structure, Congress created the Finance Board and gave it broad authority to scrutinize and oversee not only the operations of the FHLBanks, but also the securities disclosures made by the FHLBank System and the FHLBanks.

⁶ 12 U.S.C. § 1426; 12 C.F.R. pts. 931, 933.

No other entity does what the FHLBanks do. For that reason, they have a separate regulator, the Finance Board, which is solely responsible for the regulation and supervision of just twelve FHLBanks. It can utilize its in depth knowledge of the individual FHLBanks gained through supervision and examination to assess the timeliness, accuracy and adequacy of FHLBank System and individual FHLBank disclosures. Further, the Finance Board is not just a safety and soundness regulator. It also exercises power over the FHLBanks' operations through the review and approval of each FHLBank's capital plan and through the direct appointment of approximately one-third of the persons who serve on the board of directors of each FHLBank. Based on this unique statutory and regulatory construct, the Finance Board is in the best position to mandate and evaluate FHLBank System and FHLBank disclosures. Moreover, the FHLBanks believe that this is precisely the regulatory structure that Congress envisioned and enacted into law in 1932, and ratified in 1999.⁷ Accordingly, we believe that the Finance Board is the federal agency that the FHLBanks should report to regarding their capital stock, the COs and, when authorized, mortgage-backed securities.

Let there be no misunderstanding, however. The FHLBanks view the efficiency of this regulatory regime as a means of achieving the highest quality disclosure standards, rather than as an excuse to limit or avoid disclosure.

⁷ In 1999, Congress enacted the Gramm-Leach-Bliley Act. Pub. L. No.106-102, 113 Stat. 1338 (1999). ("GLB Act"). Title VI of the GLB Act, "Federal Home Loan Bank System Modernization," amended, among other things, the capital structure of the FHLBank System, capital requirements applicable to the FHLBanks and the FHLBank System requirements applicable to their members.

**3. THE FINANCE BOARD HAS CREATED A SECURITIES DISCLOSURE REGIME
THAT IS TAILORED TO THE UNIQUE CHARACTERISTICS
OF THE FHLBANK SYSTEM**

The Undersecretary for Domestic Finance of the U.S. Department of the Treasury has suggested that the FHLBanks should register their capital stock with the SEC under the 1934 Act. With all due respect to the Undersecretary and the purposes that he is attempting to achieve, we believe that the result would radically alter and reconstruct the fundamental nature of the FHLBank System that the Congress created.

Frankly, we question the benefit of changing the regulation of a system that has:

- worked efficiently for more than 70 years;
- become one of the largest issuers of debt in the world;
- never suffered a loss on an advance to a member;
- always provided the capital markets with the information they require to function efficiently; and
- functioned extremely well from the perspective of its member owners, and the public at large.

The Treasury's suggestions communicated to the Finance Board, which we note is an independent agency with its own statutory obligations and authorities under the FHLBank Act,⁸ discount the structural uniqueness of the FHLBank System.

The Finance Board has effectively implemented an SEC-based disclosure regime through Part 985 of its regulations,⁹ which mandates SEC-like disclosures in connection

⁸ 12 U.S.C. §§ 1422a, 1422b.

⁹ 12 C.F.R. pt. 985.

with the COs. In doing so, the Finance Board has properly exercised its statutory authority and has done an excellent job in creating a disclosure regime that is based on SEC regulation, but that is tailored to reflect the unique structure and business of the FHLBank System and its member owners. This disclosure regime, as discussed further below, has functioned well and is known and accepted in the marketplace.

4. THE CURRENT FHLBANK SYSTEM DISCLOSURE REGIME IS EFFECTIVE, EFFICIENT, SAFE AND SOUND

Because of the unique financial nature of the FHLBank System, it is not practical to talk about FHLBank capital stock and the registration and disclosure requirements that should apply, without first considering how COs operate and are issued. Until January 1, 2001, the Finance Board, in accordance with the mandate of Section 11(c) of the FHLBank Act,¹⁰ acted as the issuer of COs. As issuer of COs, the Finance Board prepared and was responsible under the law for the annual and quarterly financial reports and securities disclosure of the FHLBank System. In June 2000, the Finance Board issued a rule under Section 11(a) of the FHLBank Act¹¹ delegating the authority to issue COs to the twelve FHLBanks, beginning on January 2, 2001. In connection with this transition, the Finance Board retained the disclosure regime it had designed several years earlier to ensure that investors in COs receive high quality securities disclosure, while at the same time recognizing the unique circumstances presented by the COs.¹²

¹⁰ 12 U.S.C. § 1431(c).

¹¹ 12 U.S.C. § 1431(a).

¹² Office of Finance Regulation, 65 Fed. Reg. 36290.

That disclosure regime was created in July 1998, when, after a careful review, the Finance Board issued a policy statement requiring that the FHLBank System's annual and quarterly reports, to the extent practicable, be prepared generally in accordance with the requirements of the SEC's Regulations S-K and S-X.¹³ In recognition of the special circumstances relating to the COs and the unique structure and business of the FHLBank System, the Finance Board necessarily authorized a limited number of exceptions to the requirements of Regulation S-K.¹⁴ Following the adoption of the policy statement, Finance Board staff generally followed SEC standards in the preparation of annual and quarterly reports.

As part of the Finance Board's decision to authorize the twelve FHLBanks to become the joint issuers of the COs, the Finance Board carefully considered how the securities disclosure responsibilities for the COs should be handled once this transition became effective. In this regard, the Finance Board adopted Section 985.6 of its regulations,¹⁵ drawing on its experience in implementing SEC-consistent annual and quarterly report disclosures under the policy statement. As noted, Section 985.6 requires the OF to prepare the combined annual and quarterly financial reports for the FHLBank System in a manner that is generally consistent with the requirements of the SEC's Regulations S-K and S-X, subject to certain specified exceptions determined by the Finance Board in light of the special circumstances relating to the COs and the FHLBank System.¹⁶ The

¹³ Statement of Policy: Disclosures in the Combined Annual and Quarterly Financial Reports of the Federal Home Loan Bank System, 63 Fed. Reg. 39872, 39874-75 (1998).

¹⁴ *Id.* at 39875.

¹⁵ 12 C.F.R. § 985.6.

¹⁶ 12 C.F.R. § 985.6(b)(1)–(3); 12 C.F.R. pt. 985, app. A.

OF is required to file annual reports with the Finance Board and to distribute them to each FHLBank and FHLBank member within 90 days after the end of the fiscal year, and to also file and distribute quarterly reports within 45 days after the end of the first three fiscal quarters of the year.¹⁷

Furthermore, the regulation provides that the Finance Board, in its sole discretion, shall determine whether or not an annual or quarterly report complies with the standards of Part 985.¹⁸ The regulation provides that the OF board of directors must comply promptly with any directive of the Finance Board regarding the preparation, filing, amendment or distribution of the FHLBank System annual or quarterly combined financial reports.¹⁹ Thus, the regulation imposes a continuing duty on the Finance Board to review each annual and quarterly report for compliance with SEC disclosure requirements under Regulations S-K and S-X. The efficacy of this oversight is greatly enhanced by the Finance Board's ongoing on-site examination of the FHLBanks' books and records and monitoring of detailed financial data. Given its 70 years of experience in examining the FHLBanks, and the depth of knowledge regarding the operations and financial condition of the individual FHLBanks acquired as a result of its examination and supervisory powers, the Finance Board is in the best position to regulate the FHLBanks' disclosures.

As an example of the "hand and glove" efficiencies that exist in the Finance Board's oversight of the FHLBanks' activities and securities issuance, the Finance Board

¹⁷ 12 C.F.R. § 985.6(b)(4).

¹⁸ 12 C.F.R. § 985.6(b)(5).

¹⁹ 12 C.F.R. § 985.6(b)(6).

routinely ensures that payments on the COs are made in a timely manner.²⁰ Moreover, before the end of each quarter, and before declaring or paying any dividends for that quarter, the President of each FHLBank is required to certify to the Finance Board that the FHLBank, among other things, will remain capable of making full and timely payment of all of its current obligations coming due during the next quarter.²¹ In addition to this unique certification requirement, each FHLBank is required to immediately give notice to the Finance Board if it is unable to provide the certification, or if certain other events are projected to occur.²² Finally, in this regard, under Sections 966.9(d) and (e), the Finance Board can, in its discretion, order any FHLBank to make any principal or interest payment due on a CO, subject to a reimbursement obligation by the FHLBank on whose behalf the payment is made.²³ In short, unlike the SEC, the Finance Board has substantive authority and responsibility over the debt issuance process and may exercise control over many of the financial decisions that are material to the FHLBank System and FHLBank disclosures, including taking affirmative action to ensure that investors in COs receive timely payment of principal and interest.

While the FHLBanks do share significant financial liability with each other with regard to the COs, they are not able to assess fully the likelihood of incurring this liability or the potential impact that such a liability may have on them. No FHLBank can speak to the financial position or other issues within another FHLBank. Because of this joint and several linkage between and among the FHLBanks created by the COs, the Finance

²⁰ 12 C.F.R. § 966.9.

²¹ 12 C.F.R. § 966.9(b)(1).

²² 12 C.F.R. § 966.9(b)(2).

²³ 12 C.F.R. §§ 966.9(d)-(e).

Board is best positioned to establish and oversee a disclosure regime for the FHLBanks' capital stock, one which is capable of responding efficiently to the financial developments within the FHLBank System and ensures timely and accurate disclosure for the protection of FHLBank investors. Because the Finance Board, through the exercise of its supervisory authority is very familiar, on a continuing basis, with the management, business strategies, operational policies and financial condition and prospects of each of the twelve FHLBanks, it can assure that there is a regulator with detailed knowledge of the individual FHLBanks whose responsibilities are focused entirely on ensuring that the FHLBanks and the FHLBank System operate with safety and soundness and provide meaningful disclosure to investors and the public.

When standard SEC-like rules are applied and enforced by a government agency, like the Finance Board, which has the broadest authority over and the most in depth financial knowledge about the entities making the disclosures, it creates a very effective and efficient securities disclosure regime that protects both FHLB System investors as well as American taxpayers. We urge the Finance Board to ask our member owners, those who would arguably primarily benefit from registration of our capital stock under the 1934 Act, whether they perceive any benefit to registration of their FHLBank stock under the 1934 Act, as compared to under a disclosure framework implemented by the Finance Board. The Finance Board should similarly contrast any such perceived benefit with the additional burdens and costs that such registration would impose on the FHLBanks, as well as their member owners. We are confident that our member owners see no benefit, and likely see significant disadvantages to registration under the 1934 Act.

The goals of transparent, timely and complete disclosure can easily and more efficiently be met by the Finance Board without requiring registration of FHLBank capital stock under the 1934 Act. Member owners will not benefit by having the responsibility for reviewing FHLBank capital stock disclosures transferred from the Finance Board to the SEC, particularly if the same SEC disclosure requirements, appropriately tailored to the FHLBank System, are applied by the Finance Board. While it is entirely appropriate to reevaluate whether current Finance Board disclosure requirements need to be improved in light of the current business environment, there is simply no substantive or legal basis to suggest or require that the responsibility for or jurisdiction over those disclosures should or could be transferred to the SEC.

Parenthetically, we note that the interests of the taxpayers in the FHLBank System are distinguishable from those of the member owners and CO investors. The interests of the taxpayers are the interests that were represented by Congress when it established the predecessor to the Finance Board in 1932 and gave it broad regulatory and supervisory authority over the FHLBank System. Those are the interests that Congress had in mind when it amended and expanded the authority of the Finance Board in various legislative enactments since that time. Those are the interests that the Finance Board's safety and soundness authority are meant to protect. The Congress has already determined how the taxpayers are protected, and we believe that the most effective way for the Finance Board to do so is for it to maintain its Congressionally-assigned role as the sole overseer of the FHLBank System. In the final analysis, the delegation of disclosure authority over the FHLBanks to another agency will not provide any added protection to the taxpayers.

5. THE PUBLIC COMPANY REGISTRATION MODEL DOES NOT ACCOMMODATE THE UNIQUE STRUCTURE OF THE FHLBANK SYSTEM

The SEC reviews disclosures by public companies, which sell their securities to the general public. These securities trade in the market and fluctuate in value based on financial performance and other market factors. In most cases, those public companies have no federal or state regulator that has plenary authority over their activities.

None of these things are true about the capital stock that the FHLBanks issue, however. The Finance Board is a comprehensive regulator of the FHLBanks. It determines what activities are mission-oriented,²⁴ which may be expanded,²⁵ and even when a FHLBank should be merged or liquidated.²⁶ As noted above, the capital stock of the FHLBanks is purchased and held only by its financial institution member owners, who in most cases, are required to initially purchase the stock as a condition of membership and to make further purchases based on the level of member activity. FHLBank stock is issued, transferred, repurchased and redeemed only at par, no member can purchase stock in a FHLBank in which it is not a member, and no FHLBank stock can trade on any public securities exchange or trading market. While the COs are sold in public markets, they do so based on the strength of SEC-based disclosure materials disseminated by the OF, pursuant to Finance Board rules.

Furthermore, the retention of jurisdiction by the Finance Board over FHLBank System CO disclosures, while delegating individual FHLBank capital stock disclosures to the SEC under the 1934 Act, would provide no added disclosure benefits. In fact, it would

²⁴ 12 C.F.R. pt. 940.

²⁵ 12 C.F.R. pt. 980.

²⁶ 12 U.S.C. § 1446.

impose two regulatory regimes on FHLBank-related disclosures, create redundant compliance costs and give rise to potentially inconsistent regulation and disclosure mandates. In that regard, as further described later in this testimony, any conflict or lack of consistency between these two regulatory regimes may have an unintended adverse impact on the FHLBank System's access to the debt markets.

Another important benefit of having the Finance Board responsible for the securities registration and disclosure obligations of the FHLBanks is the undivided attention that the Finance Board and its staff can give to FHLBank matters. Each FHLBank has an annual on-site examination of its books and records that support the preparation of its financial statements. Moreover, the Finance Board constantly monitors each FHLBank's monthly, quarterly and annual financial data, providing an almost real time review. The SEC, in contrast, has responsibility for reviewing the securities filings of thousands of issuers and as a practical matter, the SEC does not routinely examine the business and financial condition of the companies that report to it. The SEC is simply not in a position to bring the same in-depth knowledge of the FHLBank's business, financial condition and performance to FHLBank securities disclosure as the Finance Board, which has the regulation and supervision of the FHLBank System as its sole responsibility.²⁷

As this testimony demonstrates, the FHLBank System is a "square peg" that does not easily or efficiently fit into the public company "round hole" disclosure regime. Public companies issue stock to the public; the FHLBanks do not. Public company stock

²⁷ In reaction to concerns over the limited amount of review that the SEC was giving to filings by 1934 Act registrants, the Sarbanes Oxley Act mandates that the SEC review a registrant's filings at least once every three years. Pub. L. No. 107-204, § 408 (2002).

trades in the public markets, and that stock may fluctuate in value. FHLBank stock does not. Public companies do not jointly issue their debt with other independent companies; the FHLBanks do.

The FHLBank System has been a remarkable success story that should not be altered unless there are quantifiable benefits to be achieved from the proposed modification. The FHLBanks see none that would arise from registration of their capital stock under the 1934 Act that have not already been achieved or could be achieved by enhanced Finance Board regulation. This is in contrast to the benefits that may be recognized as a result of Fannie Mae and Freddie Mac voluntarily registering their stock under the 1934 Act. Fannie Mae and Freddie Mac are individual public companies that are not financially linked in any way. They do not have a federal regulator with comprehensive authority over them,²⁸ and they do sell stock to the public, which trades on the New York Stock Exchange.

**6. UNDER THE STRUCTURE ESTABLISHED BY CONGRESS,
THE FINANCE BOARD HAS JURISDICTION OVER THE SECURITIES DISCLOSURES
OF THE FHLBANKS AND THE FHLBANK SYSTEM**

The Finance Board has the statutory responsibility and authority to regulate FHLBank securities disclosure. The best proof of that is the Finance Board's previous exercise of this authority.²⁹ As the Finance Board itself said, the jurisdiction of the Finance Board includes regulating the securities activities of the FHLBanks for both "the protection of

²⁸ Unlike the Finance Board's broad authority over FHLBanks, the Office of Federal Housing Enterprise Oversight ("OFHEO") has limited safety and soundness authority over Fannie Mae and Freddie Mac. OFHEO has not issued, nor has it ever proposed, regulations that would impose securities disclosure requirements on those GSEs.

²⁹ 12 C.F.R. § 985.6(b), pt. 989.

investors and the Bank system.”³⁰ If it did not have that authority, it could not have legally promulgated its current securities disclosure regulations.³¹ And, if the Finance Board has this authority to create and implement a securities disclosure regime, as it must believe it does, it would be inconsistent with the purpose of the FHLBank Act to abdicate that authority and create a different regulatory regime than Congress intended.³²

Under the FHLBank Act, the Finance Board is obligated to ensure that “the FHLBanks carry out their housing finance mission.”³³ It must also ensure that the FHLBanks “operate in a financially safe and sound manner,”³⁴ and that the FHLBanks are “able to raise funds in the capital markets.”³⁵ The Finance Board is further charged by Congress with the authority to promulgate and enforce regulations necessary to carry out these purposes,³⁶ and to define FHLBank capital and implement capital requirements.³⁷

³⁰ Financial Disclosure by the Federal Home Loan Banks, 63 Fed. Reg. 39702, 39703 (1998).

³¹ 12 C.F.R. § 985.6(b), pt. 989.

³² The Supreme Court has expressly prohibited agencies from exercising authority “in a manner that is inconsistent with the administrative structure that Congress has enacted into law.” *Food and Drug Administration v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 125 (2000) quoting from *ETSI Pipeline Project v. Missouri*, 484 U.S. 495, 517 (1988). See also *MCI Telecommunications Corp. v. American Telephone and Telegraph Co.*, 512 U.S. 218, (1994) (finding it highly unlikely that Congress would have left a major decision regarding the degree of regulation of an industry to agency discretion and rejecting the imposition of a new scheme of regulation, saying that while it may be a good idea, it was not the idea Congress enacted). See also Memorandum from Department of Justice, Office of Legal Counsel to Eugene A. Ludwig, Comptroller of the Currency (Dec. 15, 1994) (finding that the federal banking agencies lacked the authority to issue regulations under the Community Reinvestment Act (“CRA”) that would permit the agencies to take enforcement action against institutions that are found not to be in compliance with their obligations under agency CRA regulations).

³³ 12 U.S.C. § 1422a(a)(3)(B)(ii).

³⁴ 12 U.S.C. § 1422a(a)(3)(A).

³⁵ 12 U.S.C. § 1422a(a)(3)(B)(iii).

³⁶ 12 U.S.C. § 1422b(a)(1).

When FIRREA was enacted, Congress abolished the various joint offices that had been established by the Federal Home Loan Bank Board, but expressly preserved the OF with its special role of serving as the agent for issuing the COs for the entire FHLBank System.³⁸ Congress recognized the efficiency of issuing the COs in the manner best suited for obligations that were joint and several obligations of all twelve FHLBanks. In short, the Finance Board was intended by law to be the FHLBanks' securities regulator, as best evidenced by the interrelated nature of the FHLBank System, the broad authority Congress gave the Finance Board over the FHLBank System, the congressionally-imposed responsibility on the Finance Board to ensure FHLBank System access to the capital markets, and the Finance Board's exercise of that precise authority in the past. In this regard, delegation to the SEC of disclosure responsibility for the FHLBanks and/or the FHLBank System would fundamentally depart from both the language and the spirit of the FHLBank Act.

The appropriateness of the exemption for FHLBank and FHLBank System securities from registration under the Securities Act of 1933 and under the 1934 Act is not a new issue. In fact, the policy positions supporting retention of Finance Board oversight over the FHLBanks' disclosures are longstanding and have recently been reviewed and continued. Indeed, over the years, federal regulators, including the Finance Board, have consistently recognized that the FHLBanks are not subject to the registration and reporting requirements of the federal securities laws. We believe these policy positions continue to be the right ones.

Footnote continued from previous page

³⁷ 12 U.S.C. § 1426(a).

³⁸ Pub. L. No. 101-73, § 702 (1989) (codified at 12 U.S.C. § 1422b(b)(2)).

In 1997, the Finance Board wrote to Congressman Oxley regarding the provisions of a proposed amendment to H.R. 10, a predecessor to the Gramm-Leach-Bliley Act (“GLB Act”), which would have subjected debt securities issued by the Finance Board or the twelve FHLBanks to the registration and reporting requirements of the federal securities laws and oversight by the SEC.³⁹ The Finance Board stated that “the securities of the FHLBank System have been exempt from such requirements since the System’s creation over 60 years ago,” and that the cost of registration and such a change in the regulatory structure would create enormous costs which would be passed on to home buying consumers.⁴⁰ However, these provisions were ultimately deleted from the version of H.R. 10 that was reported to the Commerce Committee and never became law.⁴¹ It is logical to infer from this legislative history of the GLB Act that securities issued by the FHLBanks are viewed by Congress as exempt from the SEC registration process. Otherwise, there would have been no reason to introduce the proposed amendment in the first place. The fact that the amendment was not adopted is support for the proposition that Congress saw no reason to disturb the status quo and subject the FHLBanks to the SEC registration process and SEC jurisdiction.⁴²

³⁹ See Staff of the Subcommittee on Finance and Hazardous Materials, Committee on Commerce, 105th Cong. (Committee Print Oct. 23, 1997).

⁴⁰ Letter of October 20, 1997, to the Honorable Michael G. Oxley, from Chairman Bruce Morrison.

⁴¹ See Financial Disclosure by Federal Home Loan Banks, 63 Fed. Reg. 5315, 6 (1998) (“Financial Disclosure Proposal”).

⁴² See *United States v. Clark*, 454 U.S. 555, 564 (1982) (“Congress’ failure to correct [a] practice, . . . at the very time Congress was revamping the laws applicable . . . provides further evidence of its intent that [the] status quo remain”).

In addition, in 1992, the SEC, the Department of the Treasury and the Federal Reserve Board expressly recognized the fact that GSE securities (in this case, defined to include Fannie Mae, Freddie Mac, the Farm Credit System, the FHLBank System and Sallie Mae) “historically have been exempt from registration under the federal securities laws” and “generally are deemed to be ‘government securities’ within the meaning of the Securities Exchange Act of 1934. . . .”⁴³ Indeed, that fact formed the basis for their argument that the securities laws should be amended to require GSE equity and unsecured debt to be registered and made subject to the federal securities laws.⁴⁴ No such changes to the law have been made.

In 1998, in the Supplementary Information accompanying the Finance Board’s proposed amendments to its regulations requiring the FHLBanks to provide annual and quarterly audited financial statements in conformance with the requirements of the SEC, the Finance Board stated:

[S]ecurities issued by both the Finance Board and the Banks are exempt from the registration requirements of the Securities Act [of 1933]

Classes of securities issued by the Finance Board and the Banks similarly are exempt from the registration and reporting requirements of the Securities Exchange Act of 1934

The applicable exemptions under both the Securities Act and the Exchange Act are principally grounded in a presumption that the securities activities of institutions acting as government entities, as designated under the federal

⁴³ See JOINT REPORT ON THE GOVERNMENT SECURITIES MARKET, app. D-2 (Jan. 1992).

⁴⁴ *Id.* at 34.

securities laws, will be conducted in the public interest and for the protection of investors.⁴⁵

Thus, using these agencies' own conclusions over the last ten years, it seems clear that the Finance Board has been given the statutory authority and regulatory responsibility regarding the registration and disclosure of FHLBank securities. It must follow then that the Finance Board should not abandon its statutory responsibility, especially in light of the repeated acceptance by Congress of the current structure.

7. Voluntary SEC Registration of FHLBank Capital Stock Raises Potential for Unintended Consequences to the FHLBank System and the FHLBanks

Chairman Korsmo has publicly stated that the Finance Board does not intend to require the FHLBank System to register COs and, if ultimately approved, mortgage-backed securities, with the SEC under the Securities Act.⁴⁶ In reaching this determination, the Chairman properly recognized that subjecting the FHLBank System's capital raising activities to SEC registration would be unnecessarily disruptive and costly and could potentially impact the FHLBanks' safety and soundness due to potential delays in executing transactions caused by the SEC registration process. Moreover, registration of the FHLBanks' capital stock with the SEC under the 1934 Act could also indirectly lead to the same potential disruptions in the ability of the FHLBank System to raise capital in the markets through the issuance of COs. For example, a material comment made by the SEC staff in the course of a periodic SEC review of a single FHLBank's

⁴⁵ See Financial Disclosure Proposal, 63 Fed. Reg. at 5315-16. While not specifically cited by the Finance Board, an exemption from registration under the 1934 Act for securities of "cooperative banks" that are subject to federal examination and supervision should be available to the FHLBanks. The FHLBanks are clearly cooperatives and are subject to examination and supervision by the Finance Board.

⁴⁶ Remarks by Finance Board Chairman John T. Korsmo at Conference of Federal Home Loan Bank Directors, November 14, 2002.

1934 Act filings on a disclosure or accounting matter that was a Finance Board convention but a novel issue for the SEC, could cause the FHLBank System to suspend offerings of COs until the comment was resolved to the satisfaction of the SEC staff. The extent of any delay caused by such an occurrence is impossible to predict and, depending on the complexity of the issue, could be lengthy. Such a result would be inconsistent with the Finance Board's statutory responsibility to ensure that the FHLBanks have access to the capital markets.

The potential effects of such a disruption in the FHLBank System's financing activities could be costly and create systemic problems. For example, one or more of the FHLBanks could be unable to fund member commitments or experience a significant adverse impact on its ability to maintain required capital levels. The potential risk of interruption or delays in accessing the capital markets could encourage the FHLBank System to routinely issue more debt than it otherwise would in order to ensure sufficient liquidity in the event of such a temporary disruption, thereby increasing the FHLBank System's overall leverage or otherwise affecting the management of the FHLBanks' balance sheets.

Furthermore, the SEC staff, in the course of a review of an individual FHLBank's disclosures contained in its 1934 Act filings, may take a different view from the Finance Board with regard the presentation and disclosures regarding the COs. This could have significant implications not only for that FHLBank's disclosures and financial statements, but also for the disclosures and financial statements presented by the FHLBank System and the other FHLBanks. This would result in the SEC effectively acquiring indirect oversight over the CO disclosures, despite the lack of any Congressional authority and the stated intention of the Finance Board to retain its own jurisdiction over those

securities. Depending on the complexity or significance of the issue raised and the position taken by the SEC staff in such a situation, the capital level and funding risks to the FHLBanks and FHLBank System described in the immediately preceding paragraph may be triggered.

Moreover, as the twelve FHLBanks are co-obligors with regard to the COs, any comments issued by the SEC staff relating to COs raise the issue of whether any individual FHLBank has the authority to commit other FHLBanks or the FHLBank System as a whole to SEC-mandated disclosures and accounting with regard to the COs.

**8. THE FHLBANKS SUPPORT THE ADOPTION BY THE FINANCE BOARD
OF AN ENHANCED DISCLOSURE INITIATIVE
FOR BOTH THE FHLBANK SYSTEM AND THE INDIVIDUAL FHLBANKS**

As stated above, the FHLBank System is currently subject to effective SEC-based disclosure obligations administered by the Finance Board. Moreover, the marketplace, which includes FHLBank members and public investors in the COs, has historically relied on and been satisfied with the nature and quality of those disclosures, particularly as they have been improved over time by both the Finance Board and the OF. However, the FHLBanks also recognize that the current business and regulatory climate has created an opportunity for the FHLBanks and the FHLBank System to take a fresh look at their disclosure practices and to work with the Finance Board to enhance those disclosures while continuing to ensure the safety and soundness of the FHLBanks and the integrity of their housing finance mission. In that regard, over the past several months, the FHLBanks have been working closely with their accounting and legal advisors to better educate themselves and the Finance Board staff on current and proposed SEC disclosure requirements and best practices so as to ensure that the

Chairman's goals of enhanced disclosure and transparency are realized at the end of this effort.

As a product of this educational process, the FHLBanks have developed and are prepared to work together with the Finance Board to implement a more robust disclosure framework for the FHLBanks and the FHLBank System that would continue to be administered by the Finance Board. Broadly stated, the framework envisioned by the FHLBanks would provide disclosure both at the FHLBank level and the FHLBank System level comparable to that required of SEC reporting companies, except with specific modifications necessitated as a result of the unique attributes of the FHLBank System or the FHLBanks' capital stock described above.

9. OVERVIEW OF FHLBANKS' ENHANCED DISCLOSURE PROPOSAL

Overview

The FHLBanks' enhanced disclosure proposal would convert the Finance Board's existing disclosure framework, which focuses on public disclosure of FHLBank System information (with the FHLBanks providing financial information to the OF in order to facilitate the preparation of the combined FHLBank System annual and quarterly reports), into one in which there is a public reporting obligation for both the FHLBank System and the individual FHLBanks. Furthermore, with regard to the FHLBank System, the proposal would enhance the Finance Board's existing disclosure framework by increasing the frequency of FHLBank System reporting and requiring FHLBank System debt offering disclosures to conform more closely with SEC offering disclosure requirements. The FHLBanks are prepared to bear the costs of any additional resources necessary for the Finance Board to have the staffing level required to implement enhanced disclosures through the normal assessment process.

FHLBank Reporting

The FHLBanks' proposal as it relates to individual FHLBank disclosures is based on the framework applicable to companies whose equity securities are registered under the 1934 Act. The enhanced disclosure initiative envisioned by the FHLBanks would revise existing Finance Board regulations to require mandatory annual, quarterly and current reports by the individual FHLBanks that would be comparable to the SEC's Form 10-K annual report, Form 10-Q quarterly report and Form 8-K current report, subject to limited modifications where the requirements of those forms are incompatible with the cooperative nature and structure of the FHLBank System or the attributes of the FHLBank capital stock. By specifically referencing the corresponding SEC reports (rather than using existing references to Regulations S-K and S-X of the SEC contained in the regulations), the proposed initiative would encompass all disclosure requirements applicable to such SEC reports, whether they were contained in Regulation S-K, Regulation S-X, or other rules, forms or SEC guidance. For example, under this approach, each FHLBank's reports would be required to include the CEO and CFO certifications required for public reporting companies and reflect the proposed rules issued by the SEC relating to pro forma financial measures, off-balance sheet disclosures and other existing and future disclosure policy guidance, such as guidance on critical accounting policies and estimates. In addition, the proposal would automatically include the additional reportable events recently proposed by the SEC to be added to Form 8-K, with the Finance Board providing specific interpretive implementation guidance as needed, such as where occasioned by the nature of the FHLBank's business and the structure of the FHLBank System.

To promote widespread public access to these mandated disclosures, the proposal contemplates that an FHLBank's reports would both be filed with the Finance Board

and made and kept publicly available on the FHLBank's website. In addition, to assure accountability and clear oversight over these disclosures, the FHLBanks' proposal contemplates that the Finance Board would retain the right to review the FHLBanks' filed reports and require any changes that it determined to be necessary. Furthermore, to continue to ensure the quality and integrity of the FHLBanks' financial statements, annual financial statements would be required to be audited by a public accounting firm that meets the standard of independence required for auditing SEC reporting companies and quarterly financial statements would be required to be subject to a limited review by the independent accountants comparable to that required for SEC reporting companies.

In addition, in several instances the FHLBanks' proposal requires additional disclosures as a result of FHLBank-specific situations. For example, the proposal contemplates that, in addition to the items specified in Form 8-K, the FHLBanks would be required to file current reports promptly after the provision of a written notice to the Finance Board under Section 966.9(b)(2) and the filing of a CO payment plan pursuant to Section 966.9(c) of the Finance Board regulations. In addition, although the proposal does not contemplate the filing of proxy statements due to the limited voting rights of FHLBank members and the extensive corporate governance regulations contained in the Finance Board regulations, the proposal would require the FHLBanks' annual reports to include the audit committee and compensation committee reports that would otherwise be required to be filed in an SEC proxy statement.

FHLBank System Reporting

The enhanced disclosure initiative would also provide for mandatory annual and quarterly FHLBank System reports to be prepared by the OF, the scope, form and

content of which would be comparable to the disclosures, including financial statements, required by the SEC to be included in a Form 10-K annual report and Form 10-Q quarterly report, subject to limited modifications to reflect the unique nature of the OF and the FHLBank System and especially the fact that the OF does not in any way act in a management capacity with respect to the FHLBanks. In addition, the FHLBank System would be subject to mandatory current reporting for material FHLBank System-level events that would otherwise not be required to be disclosed under the FHLBanks' enhanced current reporting obligations.

Furthermore, like the FHLBank reports, the FHLBank System's reports would be filed with the Finance Board and required to be made publicly available on the OF's website. The Finance Board would retain the right to review the filed reports and require any changes that it determined to be necessary. Furthermore, the FHLBank System's annual combined financial statements would be required to be audited by a public accounting firm that meets the standard of independence required for auditing SEC reporting companies, as is currently the case. The quarterly combined financial statements would be required to be subject to a limited review by the independent accountants comparable to that required for SEC reporting companies, as is currently the case.

FHLBank System Debt and MBS Offering Documentation

In addition to the enhancements to the FHLBank System reporting requirements described above, the proposed enhanced disclosure initiative envisioned by the FHLBanks would also require the Finance Board to adopt a rule mandating that CO offering documentation conform to SEC offering disclosure requirements, as further described below. This aspect of the FHLBanks' proposal dovetails with recent statements by the Chairman that the Finance Board intends to enhance the FHLBank System's offering disclosures for the COs and, potentially in the future, mortgage-backed securities, using SEC standards as the benchmark. Under the initiative envisioned by the FHLBanks and the Chairman, the Finance Board will establish and ensure compliance with this disclosure program.

Specifically, the debt offering disclosure proposal envisioned by the FHLBanks would require the FHLBank System offering documentation to contain the same information required to be set forth in prospectuses for large, seasoned issuers registered with the SEC for offerings of debt securities on a delayed or continuous basis, subject to modifications which are appropriate to reflect the nature of the FHLBank System and the terms and conditions of the COs, including the joint and several liability of the FHLBanks with respect thereto.

With regard to issuance of mortgage-backed securities, while the FHLBank System does not yet engage in these activities, we believe that the Finance Board should adopt new regulations that would require state-of-the-art securities disclosure standards for offerings of these securities.

10. CONCLUSION

Over the last 70 years, the FHLBanks have played a vital role in the American housing finance market. The future of their ability to effectively carry out their statutory mission depends on the Finance Board developing an approach to disclosure that will provide meaningful information to the public while preserving the safety and soundness of the FHLBanks and avoiding unnecessary costs and burdens on the FHLBank System.

There is no demonstrated abuse or market failure that has resulted from Finance Board jurisdiction over FHLBank and FHLBank System disclosures to date. In fact, current FHLBank System disclosures are SEC-based and the marketplace has not perceived any material deficiencies in those disclosures. Adoption by the Finance Board of a disclosure regulation that transfers its comprehensive authority over FHLBank and FHLBank System disclosures to another regulator that is both unfamiliar with the FHLBank System and is not also charged with supervisory power over the FHLBank System to ensure their safety and soundness is not contemplated under the FHLBank Act, is likely to lead to financing and operational inefficiencies for the FHLBanks and could potentially create unintended conflicts between the disclosure regime for the COs and, potentially mortgage-backed securities to be administered by the Finance Board and the capital stock disclosure regime to be administered by another regulator. As a result, the FHLBanks strongly believe that a robust enhanced new disclosure regulation for the FHLBanks that is administered by the Finance Board is the most appropriate way to accomplish our shared goal of enhanced transparency and disclosure.

The FHLBanks appreciate the opportunity to participate in this public hearing and look forward to a continuing dialogue with the Finance Board on this important matter.

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