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Action Modernizes FHLBank System

Finance Board Approves Final Rule On FHLBank Capital Standards

In a move with sweeping ramifications for the Federal Home Loan Bank System, the Federal Housing Finance Board approved on December 20 a final rule implementing a new capital structure for the FHLBanks. Publication of the rule will complete the Finance Board's regulatory agenda for carrying out the FHLBank provisions of the Gramm-Leach-Bliley Act (GLB).

The final rule, which follows a proposed rule published for comment July 13, replaces the FHLBanks' subscription capital structure with a more modern, flexible, risk-based capital structure. The rule establishes a permanent capital structure, made necessary by the advent of all-voluntary membership mandated by GLB, and contains risk-based and leverage capital requirements similar to those for depository institutions and the other housing GSEs.

"With input from the FHLBanks, their member institutions and other industry leaders, we have designed a flexible, workable final rule that sets the stage for a modern FHLBank System," said William C. Apgar, the HUD Secretary's Designee to the Board. "Once the new capital structure is in place, the FHLBank System, while retaining its unique coopera-

tive structure and its safety and soundness, will have a solid capital base to pursue mission-related business activities."

The final rule implements provisions of GLB that establish two classes of capital stock: Class A, redeemable on six months' notice, and Class B, redeemable on five years' notice. The rule incorporates the requirements that each FHLBank maintain a minimum ratio of total capital to total assets of at least five percent and that no FHLBank may redeem stock if it would fail to meet any of its minimum capital requirements.

Each FHLBank may

weight its permanent capital at 1.5 times paid-in value to meet the five percent test, as long as its total capital, excluding such weighting, is not less than four percent of its total assets. Each FHLBank must also have enough permanent capital to meet the rule's risk-based capital requirements for credit risk, market risk, and operations risk.

GLB requires each of the FHLBanks to submit a capital structure plan to the Finance Board for approval within 270 days of the publication of the final rule and provides for

(See **RULE**, page 2)

Proposed Rule on GLB Act Enforcement Powers Approved by Board

Addressing one of the last items mandated under Title VI of the Gramm-Leach-Bliley Act (GLB), the Federal Housing Finance Board approved on November 30 a proposed rule that establishes explicit procedures for implementing enhanced administrative enforcement powers granted by the legislation.

GLB augmented the Finance Board's broad authority to supervise the FHLBanks and issue and enforce regulations and orders under the Federal Home Loan Bank Act by adding specific powers, procedures and authorities. These added enforcement powers include: explicit authority to issue

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(RULE, from page 1)

a transition period to the new capital structure of up to three years from the effective date of each Bank's capital structure plan.

The final rule reflects a number of changes from the proposed rule requested by commenters, particularly those that might have affected the cooperative nature of the FHLBank System. The final rule eliminates provisions in the proposed rule concerning the payment of a membership fee instead of a minimum stock purchase, the trading of stock among members, and the repurchase of stock at a negotiated price.

Also removed from the proposed rule is the 40 percent limit on how much stock a member can hold in a FHLBank, and other provisions that would have changed the directorship structure. Under the final rule, voting rights in director elections remain as they are, and will be based on number of shares required to be held by each member, with adjustments to allow for state-wide averages for both Class A

and Class B stock.

In the final rule, the FHLBanks will require their members to maintain a minimum stock investment. The minimum investment includes whatever amount of stock the FHLBank requires for membership and whatever amount of stock the FHLBank requires a member to buy and hold in order to transact business (such as advances) with the FHLBank.

In response to concerns raised during the comment period about possible adverse tax implications for members, the final rule permits but no longer requires that Class A stock pay a stated dividend and does not require that Class A stock dividends have priority over Class B stock dividends.

The Finance Board has also resolved to soon issue an advanced notice of proposed rulemaking (ANPR), that will serve as a tool to encourage further comment and raise issues that may become apparent as the FHLBanks develop their capital plans.

"We don't pretend to have all the answers," said Apgar. "Until the FHLBanks take this process down the road, we won't know the right questions to ask. An ANPR with an additional public comment period will allow us to quickly, yet thoroughly, address any issues that may arise."

The rule is designed to maintain and enhance the safety and soundness of the FHLBanks. The FHLBanks will remain subject to rigorous annual examinations by the Finance Board and each FHLBank will be required to maintain a AA stand-alone rating by an independent rating agency. The FHLBank System must maintain its AAA rating on its consolidated debt obligations.

Minimum capital levels are set in statute and the risk-based capital standards are derived from the best available historic data that considers extreme stress scenarios. The final rule contains several early-warning devices to alert the FHLBanks' boards of directors of potential capital shortfalls long before they become issues of safety and soundness. **BB**

(POWERS, from page 1)

cease and desist orders, issue temporary cease and desist orders, assess civil money penalties and subpoena power.

"These are important tools for a regulator to possess," said William C. Apgar, the HUD Secretary's Designee to the Finance Board. "Now that Congress has spelled out with more precision the Finance Board's regulatory enforcement powers and procedures, the source and scope of our authorities should be crystal clear."

The proposed rule also implements provisions of GLB giving the Finance Board certain corrective action powers that Federal banking agencies have with respect to federally insured deposit institutions. It also establishes a procedural framework for conducting administrative hearings relating to enforcement actions and judicial review of final agency decisions.

The GLB provisions confer on the Finance Board substantially the same enforcement powers as OFHEO, because they incorporate many provisions of the OFHEO statute into the FHLBank Act. The proposed rule provides close parallels

with the published procedures of OFHEO and of the Federal bank regulatory agencies.

"The procedures outlined in this rule will continue to help level the regulatory playing field among all housing GSE's," said Apgar. Congressman Richard Baker, the main architect of GLB's FHLBank provisions, intends to hold hearings next

year on the topic of GSE regulation.

The proposed rule, which will have a 30-day public comment period upon publication in the Federal Register, is intended to provide the FHLBanks, the Office of Finance, Finance Board personnel and any other interested parties with sufficient notice, guidance and opportunity for comment about the procedures. **BB**

Tentative Meeting Dates Set for 2001

The Federal Housing Finance Board has released its list of tentative meeting dates for 2001. All of the meetings will be on Wednesdays in the Finance Board's 2nd floor board room at the agency's headquarters at 1777 F Street, Washington, DC.

Meeting dates are subject to change on short notice, therefore individuals planning to attend board meetings should check the Finance Board website at www.fhfb.gov to confirm the date and time.

The dates are:

January 24
February 14 and 28
March 14 and 28
April 11 and 25
May 9 and 23
June 13 and 27

July 11 and 25
August 8
September 12 and 26
October 10 and 24
November 14
December 5 and 9

Fact Sheet on Proposed rule on New FHLBank Capital Structure

BACKGROUND

Since the enactment of the Federal Home Loan Bank Act in 1932, there has been a "subscription" structure for the capitalization of the FHLBanks. Under this structure, the amount of capital stock each FHLBank issued was determined either as a percentage of the total mortgage assets of each member of the FHLBank or the dollar amount of advances outstanding to each member, whichever was greater. Under the subscription capital structure, the amount of capital each FHLBank is required to hold is not closely related to the risks posed by its investments or business practices.

On November 12, 1999, the President signed the Gramm-Leach-Bliley Act, which amended the provisions of the FHLBank Act that relate to the capital structure of the FHLBanks. As a result, the existing subscription capital structure will be replaced by a more modern capital structure, with risk-based and leverage capital requirements that are similar to those of depository institutions and the other housing GSEs. The GLB Act provided for a transition period to the new capital structure of up to three years from the effective date of FHLBank capital structure plans, during which time the prior capital provisions remain in effect. The Finance Board published a proposed rule for comment on July 13, 2000.

CAPITAL REQUIREMENTS

The final rule reflects the requirements of the GLB Act that: each FHLBank maintain a ratio of total capital to total assets of at least five percent; permanent capital (the amount of class B stock plus retained earnings) is weighted at 1.5 times paid-in value, and total capital excluding such weighting is not less than four percent of its total assets.

Total capital is defined to include:

- 1) an FHLBank's permanent capital (defined below), plus:
- 2) the amounts paid-in by members for Class A stock (which is redeemable on six months written notice)
- 3) any general loss allowance, if consistent with Generally Accepted Accounting Principles (GAAP) and not established for specific assets
- 4) other amounts from sources determined by the Finance Board as available to absorb losses.

Permanent capital is defined in GLB to include the amount paid-in by members for the Class B stock (which is redeemable on five years written notice), plus the amount of an FHLBank's retained earnings, as determined in accordance with GAAP.

The GLB Act also establishes risk-

based capital requirements under which provisions in the GLB Act require each FHLBank must maintain permanent capital in an amount sufficient to meet the credit and market risks to which the Bank is subject.

For **credit risk**, the final rule provides a regulatory framework that would assess capital charges based on the extent of the underlying credit exposure. Investments are assigned a risk factor, weighted according to estimated risk exposure. For example, FHLBank advances, which are fully collateralized, have a correspondingly low risk factor.

Under the final rule, the **market risk** requirement will be determined using a model approved by the Finance Board that subjects the portfolio to a stress test.

The final rule also imposes an **opera**
(See **FACTS**, page 4)

President Names Allan Mendelowitz To Finance Board Chairmanship

On December 28, President Clinton announced the recess appointment of Allan I. Mendelowitz to serve as chair and member of the board of directors for the Federal Housing Finance Board. Mr. Mendelowitz's nomination has been pending before the U.S. Senate since June 16, 2000.

Mr. Mendelowitz, of Middletown, Connecticut, has served as the executive director of the U.S. Trade Deficit Review Commission, a Congressionally appointed, bi-partisan panel, since October of 1999. From January 1999 to September 1999, he was vice president of the Economic Strategy Institute, where he supervised the think tank's research on trade policy, international competitiveness, and telecommunications policy.

From 1996 to 1998, as executive vice president of the Export-Import Bank of

the United States, Mr. Mendelowitz was the senior career official responsible for overseeing all Ex-Im Bank programs and operations. From 1981 to 1995, Mr. Mendelowitz had a distinguished career with the General Accounting Office as the managing director for International Trade, Finance and Economic Competitiveness, during which time he directed numerous studies of the nation's finance and economic development policies.

Mr. Mendelowitz was formerly a professor in urban and regional economics, which included housing economics, local public finance and urban economic development. He received an A.B. degree from Columbia University, and M.A. and Ph.D. degrees from Northwestern University. Mr. Mendelowitz and his wife, Sherleen, reside in Rockville, Maryland, and have two children.

RESOURCES

A recent **General Accounting Office** (GAO) report reviews changes in rural areas and in the USDA/Rural Housing Service programs and suggests Congress may wish to consider merging "similar" RHS and HUD programs. The report, titled "Rural Housing: Options for Optimizing the Federal Role in Rural Housing Development," is free from the GAO by calling 202-512-6000 or visiting its web site at www.gao.gov.

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The **Housing Assistance Council** has published "Why Housing Matters: HAC's 2000 Report on the State of the Nation's Rural Housing." The publication is free at www.ruralhousing.org or for \$9 by calling Luz Rosas at 202-842-8600 or emailing luz@ruralhome.org.

"Unlocking the Door: Keys to Women's Housing," the **McAuley Institute's** annual compilation of fact sheets about women and housing, including rural women, is free at www.mcauley.org or by calling Makeda Harris at 301-588-8110, or emailing mharris@mcauley.org.

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"Developing for the Future: Home-town USA" is a report by the **U.S. Environmental Protection Agency** addressing issues surrounding developing communities. The publication is free at www.epa.gov.livablecommunities/grants or by calling 513-891-6561.

"CDFI Policy Review: Making Capital Connections" is the **Community Development Financial Institutions Coalition's** annual forum exploring the community development finance industry's role in political, economic, and social trends. To order, email the organization at cdfi@cdfi.org or call 215-923-5363.

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Basic information about the "Section 538 Guaranteed Rural Rental Housing Program," particularly for nonprofit housing developers, is provided in a new **Housing Assistance Council** manual. Copies are available for \$5 by emailing luz@ruralhome.org or calling 202-842-8600 **BB**

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tions risk capital requirement. The rule also requires the FHLBanks to include target operating capital ratios in their risk management policies and requires each to maintain an AA stand-alone rating as determined by an independent rating agency. The FHLBank System must maintain its AAA rating on its consolidated debt obligations.

STOCK ISSUANCE

The final rule permits each FHLBank to issue either Class A stock or Class B stock, or to issue both Class A and Class B stock. Whatever classes of stock the board of directors of an FHLBank authorizes, the capital structure plan must demonstrate that the classes of stock to be issued will result in the FHLBank having sufficient amounts of permanent capital to meet the risk-based capital requirements and sufficient amounts of total capital to meet the leverage capital requirements established by the GLB Act.

The rule requires that both Class A and Class B stock have a par value that is determined by the FHLBank and included in its capital structure plan. As required by the GLB Act, Class A stock can be redeemed in cash at its par value on six months' written notice to the FHLBank. Class B stock is redeemable in cash and at par value on five years' written notice to the FHLBank. The Class B stock also confers an ownership interest in the retained earnings of the FHLBank. A FHLBank may have its stock redeemed only if it is in compliance with its capital requirements payment of the

issue price.

VOTING RIGHTS

Under the final rule, member voting rights in director elections will still be based on the average number of shares of stock held by the members in each state at the end of the preceding year, but the rule contains adjustments to allow for the possibility that an FHLBank may have two classes of stock. The rule permits, as authorized in GLB, each FHLBank to establish voting preferences for one class of stock over another.

CAPITAL STRUCTURE PLANS

As mandated by the GLB Act, the final rule requires the FHLBanks to submit capital structure plans to the Finance Board for approval within 270 days of the publication of the rule. The plan must describe which classes or subclasses of stock an FHLBank will offer to its members and indicate the terms, rights and preferences for each class or subclass of stock, such as dividend and voting rights. It must also detail requirements relating to members' minimum capital investment and describe how the FHLBank intends to implement its plan, and the features and requirements relating to any callable stock to be issued.

Also, the capital structure plan must establish criteria for transfer of stock, describe how the FHLBank will handle the disposition of stock held by institutions that terminate their membership, and include independent reports on how the implementation of the plan affects the FHLBank's redeemable stock and its credit rating. **BB**

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