Federal Housing Finance Board

News

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FHFB CHAIRMAN JOHN T. KORSMO'S REMARKS TO THE AMERICAN LAND TITLE ASSOCIATON

Thank you, Stanley (Friedlander). I appreciate the kind introduction and the opportunity to come before a group that I still consider my friends.

Today, I want to provide a brief overview of issues facing the Federal Home Loan Bank System and its regulator, the agency I chair, the Federal Housing Finance Board.

But before I proceed, let me flesh out a little bit my history that Stanley talked about. I know that he's been to the North Dakota abstractors' convention, because he knew that we sing, "The More We Get Together," every time.

I literally grew up in the title industry. When I was in junior high and high school, I did filing and deliveries and learned the basics of real estate title abstracting working in a title plant in my hometown of Fargo, North Dakota. Thirty years later, I owned the company.

Along the way, I became a lawyer. I attended Georgetown Law School, which is just a block up the street here. The only time I was actually in the building was during classes, because the rest of time I paid for law school by doing title searches in Northern Virginia for Commonwealth Title. I joke that that's the last time I had a marketable skill.

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I was later a licensed real estate title abstracter and title insurance agent in both North Dakota and Minnesota. I founded the first independent closing and escrow company in North Dakota and northwestern Minnesota and, at one time, as I recall, was one of the largest independent agents in the Title Insurance Company of Minnesota network. Unfortunately, to accept this job, I had to sell my Old Republic stock, which was painful for me. I sold my title plant and closing company right before the current refinancing boom, thus demonstrating once again the uncanny sense of timing that has characterized much of my business career.

I maintain there is no better way to learn about a community from the ground up, if you will, than through the title business, and by extension, the housing industry. Certainly, my many years as an abstracter and title agent led me to appreciate the important role played by mortgage loan officers, homebuilders, and Realtors in helping people achieve the American Dream of homeownership.

Those mortgage loan officers, homebuilders, and realtors, and the homebuyers they served, were, of course, my customers, in the same way they are yours. I had a great experience for something like 25 years serving in that way. As I said during my confirmation hearing in November of 2001, I may be the first member of the Federal Housing Finance Board who has actually closed a home mortgage package, and I have closed hundreds of them.

In short, while I am in Washington, D.C., I want all of you to understand I am not of Washington, D.C.

I came to the capital two years ago bringing with me my experiences as a business owner – sometimes successful, occasionally not – and that of someone who had been involved in the political process – sometimes successfully, sometimes not – for many years, as well as having been actively involved in my local community.

I also came to Washington with the goal of serving a President I have long admired and who I respect even more every day. His tremendous leadership over the past several months – certainly since September 11 – as he has guided this nation through difficult challenges has been truly inspiring.

The cause of freedom has advanced fundamentally in recent days, thanks, of course, to the skill and courage of our brave men and women in uniform, to allies who have supported us, and yes, thanks to President Bush and the very dedicated and talented people who serve in the Administration.

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I am not, in strict terms, part of that Administration, even though the President nominated me to serve as a director of the Federal Housing Finance Board and subsequently named me chairman.

The Finance Board is an independent regulatory agency, so while we are part of the executive branch of government, we do not fall under the authority of any of the cabinet agencies. While I pay close attention to the Administration, and certainly support many of its goals and policies, still, as an independent regulator, I'm not really in the position to address many of the issues I know are of particular interest to ALTA and which will probably be addressed far more specifically as your program goes on.

But I can talk a little bit about the Federal Housing Finance Board and the Federal Home Loan Bank System. The Federal Housing Finance Board is a five-member body, the President appointing two members of each of the two major political parties to serve for staggered seven-year terms. The President's appointments are confirmed by the United States Senate. The Secretary of Housing and Urban Development is the Board's fifth member, ensuring nominal control of the Board by the members of the President's party, although, I should say, that the issues the Finance Board deals with rarely, if ever, have a particularly partisan aspect.

As I mentioned, HUD Secretary Mel Martinez is the Finance Board's fifth, ex officio member, and has been the custom, he has named a designee to actually serve – in this case, the Federal Housing Commissioner, Dr. John Weicher. I understand you may be hearing from Dr. Weicher later, and I suspect he will be a good one to ask about HUD's RESPA reform proposals.

Being a regulator, we, of course, need something to regulate. In the case of the Federal Housing Finance Board, it's a $700 billion something, the Federal Home Loan Bank System, a system of 12 regional, wholesale banks that provide liquidity, presumably for the purpose of funding mortgage lending, to their financial institution members.

These members – there were 8,011 of them, as of December 31 of 2002 – actually own the Federal Home Loan Banks. The Banks are thus privately owned, federal-government chartered cooperatives, and the System itself also has some characteristics of a cooperative. Chief among these is that the Banks raise funds in the capital markets collectively. Debt is created in the name of the Federal Home Loan Bank System, and the 12 Banks are jointly and severally liable for its repayment.

When the System was established in 1932, thrift institutions, savings and loan associations, were required to be shareholder members. Since 1989, however, – with the passage of FIRREA, the Financial Institutions Reform Recovery and Enforcement Act – membership was made voluntary and opened up to, in addition to thrifts, insurance companies, credit unions, and commercial banks. Commercial banks, in fact, are now roughly 70 percent of the membership and account for a majority of the borrowing from the Home Loan Banks.

The reason all these institutions have bought stock and joined a Federal Home Loan Bank is pretty simple: It's a good deal. Like Fannie Mae and Freddie Mac, the Federal Home Loan Bank System is a government-sponsored enterprise, and the federal government's implicit backing allows the Banks to borrow in the debt markets at highly favorable rates. The member institutions, in turn, get a good price when they borrow from the Banks in the form of what are called advances, short-term borrowing they use, generally, as I mentioned, to finance mortgages, but, given that the borrowed dollars are fungible, they are also used to conduct other business.

I mention all this because the reality is that, despite its size and importance to the nation's financial system, the Federal Home Loan Bank System is not all that well-known.

This relative obscurity is understandable, I think. These 12 Banks rarely deal directly with the public; they have no retail customers, so to speak. When you or I buy a house, there's no particular reason our mortgage loan officer would mention the fact the ultimate source of the dollars funding our loan is an advance from the Federal Home Loan Bank of which our lender is a member.

But the fact remains, the Bank System is an extremely large institution and plays a critical role in the housing industry, which, as you know, is a major contributor to this nation's economic vitality. The System closed 2002 with almost $764 billion in assets, and last year, in addition to supplying their members with a reliable, low cost source of funds, the Banks earned them $1.8 billion in dividends.

In addition, as part of its mandate, the System is annually assessed 10 per cent of its net income to fund affordable housing programs. The $199 million in grants and subsidies awarded last year, and the $1.7 billion that have been awarded over the past 13 years, make the Federal Home Loan Banks one of the largest sources of private funding for affordable housing in the nation.

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Again, as an independent regulator, my job and that of my Board colleagues is to ensure that the System and the 12 Banks operate in a safe and sound manner and comply with the mandates of their housing finance mission. Neither I nor the Board tell the Banks how to run their businesses. Since passage of the Gramm-Leach-Bliley Act in 1999, the Banks have been free to operate according to their own business plans, as determined by their respective boards of directors and management teams.

The Banks, needless to say, are extremely sophisticated in their business operations and have developed a wide range of financial products to respond to the needs of their members. Ann asked me to touch on a couple of those, specifically the Mortgage Partnership Finance Program, or MPP, which is operated principally by the Federal Home Loan Bank of Chicago, but is an important tool of 10 of the 12 Banks, and the Mortgage Purchase Program, or MPP, which is a comparable program operated by three of the Home Loan Banks.

MPF and MPP are mortgage purchase programs through which the Home Loan Banks invest in mortgage loans acquired from the member institutions. The Federal Home Loan Banks manage the liquidity, interest-rate, and prepayment option risk of the mortgage loans, while the member institution – the local bank or savings and loan that, more often than not, originated the loan – retains a portion of the credit risk.

These acquired member asset programs have provided a mechanism for both the Home Loan Banks and their members to manage risks more effectively and efficiently, and the programs have proven highly popular. As of the end of last year, the 12 Banks held approximately $61 billion in mortgage loans in their MPF and MPP portfolios, and both programs are growing rapidly.

I recognize that any program that deals with acquiring mortgages raises questions on the part of title people as to how title assurance requirements are met.

As far as I am able to determine, there's no basis for concern when it comes to MPF and MPP. Each mortgage funded or purchased by a Mortgage Partnership Finance Bank must, under program requirements, be accompanied by a paid-up mortgage title insurance policy, or an attorney's title opinion or certificate. For FHA or VA mortgages, title insurance must comply with applicable HUD, FHA, or VA regulations.

Before I take any questions you might have, let me mention a couple of major issues currently confronting the Federal Home Loan Bank system. I mentioned that the System is a large one, with more than $700 billion in assets. It's also, as you might imagine, a major player in the debt markets.

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The System now issues just over $4 trillion of discount notes each year, (yes, that's right, I said, trillion) and sold about $420 billion in longer-term bonds in 2002. While much of discount note borrowing is overnight, at any given moment the Federal Home Loan Bank System has roughly $650 billion in debt outstanding.

That Bank System debt is purchased by somebody, and those somebodies, the individuals and institutions who are the buyers of Bank System securities, have an intense interest – a financial self-interest – in knowing all they can about the System and the quality of its debt.

And, indeed, taxpayers or those who represent them also have an intense interest in knowing whether the System can back up that debt, debt that the capital markets believe the taxpayers stand behind.

Don't get me wrong. The Federal Home Loan Bank System is incredibly strong. It is well capitalized, its advances to its members are well collateralized, and its operations are well and professionally managed. And, it goes without saying, it has a competent and watchful regulator.

But its very size and the public nature of its charter, which makes it one of the most privileged businesses in America, both go to explain why I have joined the Administration in asking the Federal Home Loan Banks to voluntarily submit to meeting the financial disclosure requirements of the 1934 Securities Exchange Act, as administered by the Securities and Exchange Commission. The Administration has called on all government-sponsored enterprises – Fannie Mae, Freddie Mac, the Home Loan Bank System, Farmer Mac, the Tennessee Valley Authority – to meet this standard, and last summer, the other two housing GSEs, Fannie Mae and Freddie Mac, voluntarily agreed to comply.

It is one of those unusual issues that has seemed to have found more a less a unanimity among the political class. Fed Chairman Alan Greenspan has indicated his support for GSE registration with the SEC, as has SEC Chairman William Donaldson and a number of key members of Congress.

Some in the Federal Home Loan Bank System, however, have reacted with trepidation to the proposal, raising several concerns – good-faith concerns, to be sure – about meeting SEC disclosure standards. I have publicly maintained that I believe voluntary SEC registration is the right thing to do for the Bank System. The SEC represents the "gold standard" of financial disclosures. It is the proven expert, with the staff, expertise, and commitment to do the job effectively, and thereby ensure the public and investors of the reliability and completeness of System disclosures.

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Discussions continue, but I did want to mention this issue because investor confidence plays a significant role in the housing industry, of which all of you an integral part.

As I noted earlier, our nation's economic health rests in great part on the health of housing. And the news has been, and continues to be, amazingly positive. Last year, the nation's homeownership rate reached a record 68 percent.

Think about that. More than two-thirds of Americans own their own homes. These homes provide financial stability for families, strengthen our communities, and they serve as individual "factories of prosperity," as a wise person once described them to me.

Homeownership doesn't just happen, of course. Many, many people are involved, beginning with the a willing seller and a willing buyer, but also including the homebuilder, the banker, the real estate agent, and yes, the title agent and underwriter.

Earlier, I noted that there is no better way to learn about a community than from the ground up. The same can be said of our nation's prosperity, that there is no better way to build the economy than from the ground up, and my friends, you in the title industry play an important role in doing just that.

Thank you for inviting me here today.

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