

TESTIMONY OF

AMERICA'S COMMUNITY BANKERS

AMERICAN BANKERS ASSOCIATION

INDEPENDENT COMMUNITY BANKERS OF AMERICA

BEFORE THE

FEDERAL HOUSING FINANCE BOARD

DECEMBER 2, 2002

America's Community Bankers (ACB), the American Bankers Association (ABA), and the Independent Community Bankers of America (ICBA) commend the Federal Housing Finance Board (Finance Board) for holding a public hearing to listen to testimony from representatives of the Federal Home Loan Banks (FHLBanks) on enhanced disclosures under the Securities Exchange Act of 1934 ("1934 Act"). The issues of proper disclosure and reporting requirements are of utmost importance to the future of the Federal Home Loan Bank System and are inextricably linked to the System's safety and soundness. We appreciate the opportunity to submit written testimony to publicly state our position supporting full, accurate, transparent and enhanced disclosures that are appropriate for the unique structure of the FHLBanks and supporting the maintenance of the Finance Board as the regulator of the System in all regards. We do, however, deeply regret that the Finance Board was not able to accommodate a FHLBank member representative, appearing in person on behalf of the three major banking trade associations, as requested in our letter dated November 22, 2002. Together ACB, ABA, and ICBA represent nearly 100 percent of the members of the FHLBank System. While ACB, ABA and ICBA's views appear to be consistent with the views expressed by Richard Swanson who is testifying as a director of the FHLBank of Seattle, he is testifying as a representative of the FHLBank of Seattle. His testimony, therefore, must comport with the views of the FHLBank of Seattle and not solely those of a member/owner of the FHLBank System.

An opportunity for a FHLBank member representative, independent of any FHLBank, to participate in the hearing discussions would have provided an invaluable perspective. As important as written testimony is, the opportunity to hear and talk with a FHLBank member solely representing shareholder concerns and perspective should have

been a priority of the Finance Board. The members of the FHLBank System are the owners of the System and it is their capital, in the form of cooperative stock and collateral, that supports the FHLBanks' activities. In the unlikely event that the System were to encounter financial problems, it is these members' capital that would stand in the first loss position.

Nonetheless, the most important result of this hearing should be the determined resolve to preserve the cooperative nature of the FHLBank System and to enhance its operations. The Finance Board is the statutorily mandated regulator of the FHLBank System with the greatest understanding of this unique structure, and it should not absolve itself of this responsibility. If the System were to be subject to a disclosure regime designed for publicly owned corporations, an unintended consequence could result, confusing investors and others who try to compare the System's disclosures with those of other companies. Full, transparent disclosures are of vital importance to the owners of and investors in the FHLBanks, but they must be disclosures that are appropriate for the cooperative System. Because disclosures must complement and enhance safety and soundness, achievement of this objective should rest with the Finance Board in consultation with the Securities and Exchange Commission (SEC). Therefore, we have serious reservations about the apparent intention of the Finance Board to delegate its authority to the SEC.

As the Finance Board has recognized, the FHLBank System is unique in that it is a cooperative that does not have publicly traded stock, but does have a public obligation. This creates a circumstance that requires careful and deliberate consideration of how full and appropriate disclosure can be provided without impairing the ability of the System or its member financial institutions to fulfill their mission and objectives. To do that, the unique nature and structure of the FHLBank System must be fully appreciated.

First, unlike other corporate models or even other housing Government Sponsored Enterprises (GSEs), the FHLBanks are cooperatives in which a member joins the FHLBank and becomes a shareholder 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 traditional public company model overseen by the SEC.

Second, the capital stock of the FHLBank System, which is its equity capital, is entirely a creature of statute¹ and is 100 percent-owned by the System's almost 8,000 member financial institutions, which range from small community financial institutions to the nation's largest depository institutions. The FHLBanks' stock is not publicly traded and does not fluctuate in value. Instead, this non-tradable stock is issued and redeemed at par value. The amount of stock outstanding rises and falls on a daily basis as members participate in the System's programs. Members generally must hold a certain amount of capital stock in relation to the amount of money they borrow from their FHLBank (advances). Each FHLBank issues stock on a daily basis to members who are taking out advances or participating in other programs that have capital stock purchase requirements. Thus, the amount of stock held by a member of the FHLBank System is related more to FHLBank activities than it is to investment expectations. Disclosure as contemplated under SEC administration of the 1934 Act would add much complexity to the System while providing little to benefit investors that would not be accomplished through Finance Board administration.

¹ 12 U.S.C. § 1426.

Third, each FHLBank manages and controls its own business activities, operations and financial performance. The twelve FHLBanks, however, are required by law to fund their operations through the issuance of consolidated obligations (COs), for which they are jointly and severally liable.² As a result, the FHLBanks operate separately, but are financially linked. This is a novel and critical factor that affects how the FHLBank System operates, how it should be regulated and what financial and other disclosures are appropriate. The Finance Board is in the best position to know what disclosures will provide meaningful benefit to interested parties, and therefore, any disclosure regime should reside at the Finance Board.

Fourth, the goal of the business of a FHLBank is not to maximize profit on each transaction in order to reward shareholders. Instead, the goal of a FHLBank is to create financial products that allow the members to maximize their ability to provide competitively priced home mortgage and community based credit products to their communities.

We feel that it is these unique qualities that require the FHLBank System have its own, specially focused safety and soundness regulator, and that that regulator also be tasked with overseeing FHLBank financial disclosures. Such regulation could and should be done in consultation with the SEC, and with appropriate standards adopted or modified where necessary. But we strongly believe that applying SEC regulation to the FHLBank System will be harmful to the System, its member/owners and to the public mission that the System serves.

² 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.

SEC registration is not without cost. We have grave concerns that SEC application of the 1934 Act to the System could have unintended consequences that might significantly increase costs to the FHLBanks and its members. The public policy purpose of the FHLBank System dictates that great care be given to ensuring that unnecessary regulatory or other costs do not occur. Unlike the cost of business decisions made by publicly traded companies that have greater flexibility in absorbing or distributing the costs or expenses, the costs imposed on the FHLBanks will directly reduce AHP funding, will either increase residential and community development credit costs or decrease credit availability and will extend the period required to pay off the REFCorp bonds. While it is important to protect taxpayers, it is equally important to weigh the costs and unintended consequences of otherwise well intended policy decisions.

As you are aware, Congress has considered the FHLBanks' framework on a number of occasions. In the Financial Institutions Reform, Recovery and Enforcement Act of 1989 ("FIRREA"), Congress recognized that the FHLBank System with its joint and severally liability was not well suited to the traditional common public company registration and disclosure conventions. As a result Congress expressly preserved the Office of Finance ("OF"). The OF is a joint office of the FHLBank System that acts as an agent of the System to issue its debt and has no counterpart in the private sector. It is precisely these unique features of the FHLBank System that led Congress to create the Finance Board and give it broad authority to be the safety and soundness regulator and to oversee the securities disclosures of the System.

Congress next took the opportunity to address the financial reporting regime of the FHLBanks as part of the Gramm-Leach-Bliley Act. Congress specifically addressed and modernized the FHLBank System altering its governance and capital structure, but

leaving the Finance Board with its broad authority to oversee the System's financial disclosures.

Most recently in response to demands for stricter corporate responsibility and following Congressional hearings on GSE financial disclosures, Congress enacted the Sarbanes-Oxley Act. Again, Congress did not modify the regulatory disclosure regime for the FHLBanks, recognizing that the cooperatively held FHLBanks were models that were different from those regulated by the SEC and thus should continue to be regulated and overseen by the Finance Board.

In conclusion, the members of the FHLBank System strongly support full, accurate, transparent, and enhanced securities disclosures that are appropriate for the unique cooperative structure of the System and carried out through the Finance Board in consultation with the SEC. On behalf of the member/owners of the FHLBanks, we commend Chairman Korsmo's desire to take a renewed look at the disclosures of the FHLBank System. The System currently has a disclosure regime, one that is modeled after that of the SEC, but with specific adjustments to accommodate the unique nature of the System. We urge the Finance Board to not relinquish its responsibilities to the SEC, but to require appropriate disclosures with reporting to the Finance Board. We specifically request that any proposed rules based on either the Securities Act of 1933 or the 1934 Act provide a minimum 90-day comment period.

On behalf of our combined memberships, ACB, ABA, and ICBA pledge to cooperate with the Finance Board to ensure that the FHLBank System continues to adhere to the best possible disclosure standards. Thank you for considering our views.

