Building Blocks

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Members Gain Flexibility

Mortgage Partnership Finance Program Approved For Entire FHLBank System

Responding to demand from FHLBank System members, the Federal Housing Finance Board has approved for use throughout the FHLBank System a successful 1997 pilot program that provides FHLBank System members with an alternative to selling mortgages to the secondary market.

The Finance Board's September 23 approval of the pilot Mortgage Partnership Finance (MPF) program for FHLBank Systemwide use allows any FHLBank to design a program for its members. Creation of a pilot MPF program by a regional FHLBank is voluntary, and a member institution may participate only in its regional FHLBank's program.

"This is a response to market demand, not only in the Chicago FHLBank's district, where MPF is already flourishing, but also in many other areas of the country where member financial institutions want to participate through their own FHLBanks," said Finance Board Chairman Bruce A. Morrison.

Under the pilot MPF pilot program, a FHLBank funds through or purchases from its member institutions single-family mortgages originated by its members. The program has proven popular in the FHLBank of Chicago district because it compensates members for assuming credit risk while the FHLBank manages interest-rate risk. Members may also benefit from a favorable capital treatment since the FHLBank holds the loan in portfolio.

"In approving MPF and other pilot programs two years ago, the board took a first step toward increasing mission-related assets," said Chairman Morrison. "The next step is to grow that success through expansion of the pilot to other areas of the country."

Before authorizing MPF on a national basis, the Finance Hoard's Office of Supervision examined and confirmed that the Chicago pilot program did not pose any safety and soundness concerns, and that it wits in compliance with the Finance Board's Financial Management Policy.

The terms and conditions approved by the Finance Board on September 23 govern the approval, establishment, and operation of all MPF pilot programs. Some of those are:

DOLLAR CAP

The Finance Board adjusted the current $750 million cap for the Chicago FHLBank on total mortgage amounts to a systemwide cap of $9 billion. The cap will not be apportioned among participating FHLBanks by any method other

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than what the Finance Board staff may deem necessary for purposes of safety and soundness.

PRICING

MPF price is the amount the FHLBank pays the participating financial institution for its responsibilities associated with the mortgage loan. This policy allows each FHLBank to set its own prices so long as the FHLBank uses a pricing methodology approved by the Finance Board staff. While a FHLBank may rely on prices set by another FHLBank. no FHLBank shall enter into an agreement that would require it to own loans at a price established by another FHLBank.

Allowing each FHLBank the opportunity to set MPF prices is consistent with maintaining the regional distinctions and flexibility that currently exists in the FHLBank System. It also will encourage a healthy competitive market discipline among the FHLBanks that may result in a lower borrowing cost for consumers.

MPF LOAN TRANSFERS

The Finance Board policy allows a FHLBank to fund or purchase only those MPF loans that are originated by its own members. However, a FHLBank may sell a MPF loan or a participation interest in the loan to other FHLBanks. Such an arrangement provides additional flexibility that FHLBanks may use to better manage risks or acquire more mission-related assets.

ADMINISTRATIVE REQUIREMENTS

Participating FHLBanks must direct MPF loan processing though an administrative office that has an operation examined and approved by the Finance Board staff. This policy offers the potential for more than one MPF administrative office to create incentives for innovation and cost-efficiency.

OTHER

1. Socio-Economic and Geographic Data Collection: The Finance Board staff may require that participating FHLBanks submit loan-specific data to the Finance Board.

2. Program Examination Criteria. The Finance Board staff will monitor MPF program data and conduct examinations as deemed necessary to ensure continuous compliance with the Finance Board's Financial Management Policy.

3. Submission of Plan: A FHLBank that offers MPF to its members must first submit a plan to the Finance Board addressing the FHLBank's ability to manage the credit risk; the FHLBank's ability to manage the risks associated with increased volume of activity; the capability of the FHLBank's administrative office; the FHLBank's criteria to determine eligibility: and a legal opinion that concludes MPF loans are investments in which a fiduciary or trust may invest under the laws of the state in which the FHLBank is located.

For more information on the FHLBank System's Mortgage Partnership Finance program, contact Christina Muradian at (202) 408-2584.

AHP Projects Win National Award

Since the creation of the FHLBank System's Affordable Housing Program (AHP) in 1990, it has often been cited as a model ofaffordable housing. In the past 8 years, AHP commitments have totaled nearly $640 million for the creation of more than 164,000 housing units in every state, territory and commonwealth of the nation.

Indicative of the acceptance of the AHP as an essential tool for affordable housing is a recent announcement that 15 AHP projects are among the 20 top recipients of the prestigious Maxwell Award of Excellence for the Production of Low-Income Housing. The awards are presented annually by the Fannie Mae Foundation to honor public- and private-sector institutions for expanding housing opportunities for underserved families and individuals and enhancing the quality of life in their neighborhoods and communities.

"These awards are additional proof that the FHLBanks, and their members, are dedicated to providing safe, affordable and decent housing for America's low-income families," said Bruce A. Morrison, chairman of the Federal Housing Finance Board, which is the safety and soundness and mission regulator of the FHLBank System. "Each of can share in the pride of this accomplishment." he said.

Maxwell Awards are presented in three categories: homeownership, rental, and special needs. Within each category there are three levels of recognition: awardee, finalist, and honorable mention. The foundation honored six awardees, 14 finalists. and 42

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Chairman's Testimony

Regulations, Mission-Related Investment Emphasized

(On September 24, Finance Board Chairman Bruce A. Morrison testified before the House Subcommittee on Capital Markets, Securities and Government-Sponsored Enterprises ofthe Committee on Banking and Financial Services. Whatfollows are excerptsfrom that testimony.)

I would like to amplify on the seriousness with which we undertake both our safety and soundness and mission responsibilities and on the affirmative ways in which we perform our duties as statutorily mandated, through our regulations, our policies and procedures, and our allocation of resources.

> "In the 65-year history of the FHLBank System, no FHLBank has ever experienced a credit loss on an advance."
>
> Bruce A Morrison
> Chairman,
> Federal Housing Finance Board

Safety and Soundness Regulation

The Finance Board is charged by statute with ensuring that the 12 FHLBanks operate in a financially safe and sound manner, [and that] is the primary duty of the entire 115-person agency.

The safety and soundness policies prescribed for the FHLBanks by the Finance Board are more stringent and conservative than those that apply to federally insured depository institutions or to other government-sponsored enterprises. The FHLBanks are AAA-rated (without regard to their implied government backing) and have not experienced a credit loss since their creation in 1932. Annual on-site examinations, together with comprehensive reporting and off-site monitoring, ensure regulatory compliance with these policies.

In the 65-year history of the FHLBank System, no FHLBank has ever experienced a credit loss on an advance.

(Mr. Morrison discussed FHLBank and Finance Board regulations and policies on control ofcredit and interest-rate risk, corporate governance, capitalization, and annual examinations that work in tandem to maintain the safety and soundness of the FHLBank System.)

Mission Regulation

The Finance Board also is charged with ensuring that the FHLBanks carry out their public purpose -- housing and community investment finance. To do so, the Finance Board must actively foster the maximizing of public benefit from the activities of the FHLBanks.

[A] mission regulator must follow at least three different strategies to ensure mission performance: (1) it must measure what is being accomplished; (2) it must authorize or refuse to authorize activities as mission-consistent, subject to safety and soundness considerations; and also (3) it must define public needs which the regulated entities should be meeting and mechanisms and procedures to move them toward doing so. "Promoting" the public interest is precisely what the Finance Board must do. And, as with safety and soundness regulation, mission regulation does, of necessity, involve the agency to some degree in theFHLBank System's business.

Again, the Finance Board looks primarily to the Bank Act, but also at the actual business and balance sheets of the FHLBanks to assess the mission performance of the FHLBanks, and at the need for regulations. policies and procedures that will foster mission achievement. The Finance Board has also identified for the FHLBanks products and activities that would advance the public interest in housing finance.

The Finance Board has never sought to tell the FHLBanks how to conduct their businesses, but it is focused on what credit needs in housing finance and community investment should be addressed and for which segments of the population. It is the proper role of a GSE regulator to set the standards within which the regulated entities must operate; this is how it ensures that the government supplied

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subsidy is directed to the maximum extent possible to the achievement of the GSE's public purpose and that this is accomplished in a financially safe and sound manner.

Arbitrage versus Mission-related Investment

Currently about 40 percent of the System's balance sheet is in assets that do not directly support the delivery of housing and community investment credit by the FHLBanks through their members. That percentage, while perhaps at one time justifiable by adverse economic conditions, is today too high. I believe that assets that do not directly support the mission of the System, other than to provide arbitrage profits to enhance System earnings, should be transformed into assets that help members provide housing and community investment credit, as advances do. Therefore, for the past three years the Finance Board has engaged in an affirmative strategy to reduce the investment portfolios of the FHLBanks. This strategy has three parts:

1. Facilitating new mission-related asset creation, including using pilot programs to create new mission-related products for members, expanding letter of credit and community investment lending authorities, and broadening collateral rules for rural members;
2. Initiating regulatory reform to limit investments to those needed for liquidity, safety and soundness and housing finance; and
3. Advocating legislative change to modify the REFCorp and capital rules to remove the structural defects in the FHLBank Act which require higher earnings than generated by advances and other mission-related products.

To further this strategy, the Finance Board in May of 1998 held hearings on changing the balance sheet of the FHLBanks based on a staff analysis.

As a result, the Banks have begun to shift their balance sheets toward a greater percentage of mission-related assets. From June 1996 through June 1998, advances as a percent of the System's consolidated obligations rose from 58 to 69 percent. Over the same period, advances plus MBS (mortgage-backed securities) have increased to just over 85 percent of consolidated obligations from just over 75 percent. Although the Ranks are moving in the right direction, without the legislative changes, only partial and gradual success in restructuring the balance sheet can be achieved without risk to the primary objective of ensuring safe and sound operation.

(The full text of this testimony is mailable by writing to the Office of Public Affairs, Federal Housing Finance Board, 1777 F Street NW, Washington DC 20006.)

Finance Board Outlines Y2K Oversight Procedures

Within the Finance Board, the Office of Supervision (OS) is responsible for Y2K oversight ofthe FHLBanks and the Office of Finance (OF). The Office of Supervision's approach to Y2K oversight is to apply the examination standards and procedures published by the Federal Financial Institutions Examination Council (FFIEC), supplemented by guidance published by the General Accounting Office (GAO). In addition, OS has engaged an information technology consultant to assist examiners in technical reviews of the testing and implementation phases of Y2K project management.

OS communicates guidance and expectations on Y2K matters to the FHLBanks through advisory bulletins conveying formal guidance, a periodic, informal newsletter dedicated to Y2K matters. and periodic meetings with FHLBank personnel involved in Y2K project management.

The FHLBanks and OF have each assigned a senior manager to oversee the Y2K project. OS requires that quarterly progress reports be made to each institution's board of directors and OS.

OS began including a Y2K review as part of its examinations in the second half of 1997. The purpose of the initial review was to ensure the FHLBanks and OF were considering Y2K issues, and to gauge their progress in doing so. For 1998 examinations, OS has intensified the Y2K portion of the examination in a two-phase approach.

In the first phase, completed June 30, OS reviewed each FHLBank and OF to assess the extent to which their Y2K project management conformed to current guidelines. Institutions identified as being behind schedule report to OS more frequently until they are on schedule.

During the second phase, which began at the start of the third quarter of 1998 and continues into mid-1999, OS will use an

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1997 Financial Report

FHLBank System Advances Top $200 Billion; New Disclosure Rules Take Effect

On July 2, the Federal Housing Finance Board released the 1997 Financial Report of the Federal Home Loan Bank System showing that advances to FHLBank System member institutions reached $202.2 billion as of December 31, 1997.

The total advances were up by $41 billion, or 23.5 percent, from the previous year. FHLBank System investments during 1997 increased to $140.1 billion, up 11.9 percent from the previous year, according to the report. The FHFB is the safety and soundness and mission regulator of the FHLBank System, and issues debt for the FHLBank system. As issuer of the debt, it prepares the combined financial report.

Policy changes that expand financial disclosure requirements for the FHLBank System noted in the annual report took effect August 23,

Previously, disclosures of financial statements of the FHLBank System were generally in accordance with the disclosures required by the Securities and Exchange Commission's requirements of its registrants. The new policy codifies earlier practices and moves the financial disclosures made be the FHLBank System closer to those made by SEC registrants. It requires the FHLBanks to prepare quarterly financial statements in accordance with generally accepted accounting practices and distribute them to their members.

"By codifying the disclosure requirements in the financial statements, we want to ensure that they comport with industry standards and that, like the SEC's rules. they represent 'best practices'," Finance Board Chairman Bruce A. Morrison said.

> FHLBank System membership reached an all-time high in 1997, with 6,504 members at the end of the reporting period.

The new financial statement includes:

- the top 10 capital stockholders in the FHLBank System and the top five capital stockholders in the each FHLBank;
- the top 10 holders of advances in the FHLBank System and the top five holders ofadvances at each FHLBank:
- transactions with related parties that show how much of total FHLBank advances went to member institutions that have an officer serving on the board of directors of a FHLBank;
- increased disclosure concerning derivatives and interest-risk management, and:
- increased disclosure on the compensation and pension plans of the FHLBank presidents and managing directors of the FHLBank System's Office of Finance, which is responsible for securing funds from capital markets for the FHLBank System's needs.

The FHLBank System funds its operations by borrowing in the capital markets, issuing debt instruments called consolidated obligations. At the end of 1997 the FHLBank System had $304.5 billion of consolidated obligations outstanding, $53.2 billion, or 21.2 percent, more than the level outstanding at the end of 1996.

Additionally, the FHLBank System sold more than $1.9 trillion in short-term discount notes during the year, according to the report.

FHLBank System membership reached an all-time high in 1997. with 6,504 members at the end of the reporting period. This surpasses the previous membership total of 6,146 set in 1996. Commercial banks accounted for 69.4 percent of the FHLBank System membership

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Texas Judge Rules For Pilot Programs

In a landmark decision, a federal district court upheld the statutory authority of the Federal Housing Finance Board to approve the Mortgage Partnership Finance (MPF) pilot program developed by the FHLBank of Chicago.

The June 25 ruling, handed down by U.S. District Court Judge Sam Sparks of the Western District of Texas in Austin, affirmed the power of the FHLBanks to invest in mortgages as a security, pursuant to various provisions in the Federal Home Loan Bank Act.

"This decision is a clear victory for consumers," Finance Board Chairman Bruce A. Morrison stated.

"The MPF offers community banks an alternative to selling loans in the secondary market and promotes competition in pricing in the retail mortgage market, thereby lowering costs to homebuyers," he stated.

Judge Sparks' ruling marks the first time a court has ruled that the FHLBank Act, on its face, allows a FHLBank to invest in mortgages as a security.

In December 1996, the Finance Board authorized a $750 pilot program for the FHLBank of Chicago that would allow its members to market and originate home mortgage loans where the member would be responsible for all functions involving customer relationships and credit risks. The Chicago FHLBank would fund the loan and retain it in its portfolio. assuming market risk. The FHLBank of Chicago received final approval to start the program in June 1997.

The program was challenged in a suit brought by thrifts and trade associations in Texas, California, and Ohio.

The court ruled that the FHLBank Act supports the MPF on three separate grounds:

- the power to make advances because the MPF does not differ in any material manner from a traditional advance;
- the power to invest in "mortgages. obligations, or other securities;" and
- undertaking the MPF is a permissible exercise of the "incidental powers" granted in the

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BEA to Award $25 Million in 1999

On September 1, a Notice of Funds Available (NOFA) for the 1999 Rank Enterprise Act (BEA) Program was published in the Federal Register officially opening .he fourth round of the program. The NOFA announced that $25 million is being made available, and more that $25 million may be awarded if it is available and there are qualified applicants.

Io assist potential applicants and other interested organizations, the CDFI Fund is conducting a series of free informational workshops across the nation in October. The workshops provide an overview of BEA Program regulations. a review of the application materials, and a forum to ask questions. Institutions considering applying to the REA Program are encouraged to attend one of the workshops though attendance is not required to submit an application.

The dates and locations of the workshops are (all dates are in October):

8 -- Louisville, KY
13 -- Dallas, TX
16 -- Atlanta, GA
19 -- Boston, MA
20 -- Chicago, IL
22 -- Baltimore, MD
21 -- Sioux Falls, SD
26 -- Seattle, OR

The BEA Program recognizes the key role played by insured depository institutions in community development lending and investing. The program provides incentives for banks and thrifts to increase their investments in community development financial institutions and to increase their lending and provision of financial services in distressed communities.

For more information, contact the CDFl Fund at (202) 622-96762, or visit them on the Internet at *www.treas.gov/domfin/cdfi*.

To obtain a 1999 BEA program application fax your request to (202) 622-7754. Be sure to indicate the institution's name, and the requester's name, title, mailing address, and phone and fax numbers.

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information technology consultant to assist examiners in reviewing the institutions' testing and implementation of remediated systems. Current literature suggests that testing and validation of systems will likely consume 60 percent or more of resources devoted to Y2K projects.

The Finance Board requires each FHLBank to adhere to the U.S. Securities and Exchange Commission (SEC) guidance for disclosure regarding Y2K matters. Further, all publicly disseminated disclosures made by the FHLBanks or OF regarding Y2K must be cleared through OS prior to distribution to ensure consistency with examination findings.

The SEC literature suggests that, for a Y2K disclosure to be meaningful, it must at least address the following four areas: the entity's state of readiness; the costs to address the entity's Y2K issues; the risks of the entity's Y2K issues; and, the entity's contingency plans.

Guidance on Y2K matters that OS employs in its oversight of Y2K matters can be retrieved from the fallowing Internet web sites: FFIEC Guidance (www.f'fiec.gov), G A 0 Guidance (www.gao.gov), and SEC Disclosure Guidance (vvww.sec.gov).

'The Office of Finance, as the fiscal agent for the Finance Board and the 12 regional FHLBanks, facilitates the issuance and servicing of all FHLBank consolidated obligations. OF is in the process of testing its internal computer systems for Y2K readiness. As part of OF'S testing process, the FHLBanks are being provided the opportunity to test their automated interactions with OF's computer systems.

In addition. OF is surveying the System's counterparties to assess their readiness for Y2K. The schedule for completion of this assessment coincides with the internal computer system testing schedule. Additional information regarding OF is available at (www.fhlb-of.com).

All questions regarding the FHLBank System's preparations for Y2K should be addressed to the Federal Housing Finance Board, 1777 F Street NW, Washington DC 20006. For questions regarding the Finance Board's internal systems the queries should be addressed Attention: Office of Resource Management; for questions regarding oversight matters, queries should be addressed Attention: Office of Public Affairs. For questions regarding investments in FHLBank consolidated obligations, write to Office of Finance, Internal Audit and Compliance Division, Suite 1000, 11921 Freedom Drive, Reston, VA 20190.

For questions regarding a specific FHLBank's preparations, the FHLBank can be contacted via a link from the Finance Board website at www.fhfb.gov/map.htm.

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Maxwell Awards are presented in three categories: homeownership, rental, and special needs. Within each category there are three levels of recognition: awardee, finalist, and honorable mention. The foundation honored six awardees, 14 finalists, and 42 honorable mentions.

Five AHP projects were named as awardees and 10 were named as finalists.

The AHP projects in the awardees category are: A Community of Friends, Los Angeles, CA; Everglades Community Association, Inc., Homestead, FL; Frontier Housing, Inc., Morehead, KY: Proyecto Azteca, San Juan, TX; and The Colorado Coalition for the Homeless, Denver, CO.

The AHP projects in the finalists' category are: Century Place Development Corporation, Chicago, IL; Community Development Corporation of Brownsville, Brownsville, TX; Community Family Life Services, Washington, DC; Homes in Partnership, Inc., Apopka, FL; and Interfaith Housing Development Corporation of Chicago, IL.

Additional AHP projects in the finalists' category are: LTSC Community Development Corporation. Los Angeles, CA; Mission Housing Development Corporation, San Francisco, CA; N Street Village, Washington, DC; Stop Abusive Family Environments, Inc., Welch, WV; and Venice Community Housing Corporation, Venice, CA.

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in 1997, while the number of thrifts, which previously dominated the membership totals, declined.

In spite of the decline in the number of thrifts. these institutions still held 70 percent of all advances in 1997.

Ten of the largest FHLBank System borrowers last year were thrifts, five of which are headquarters in California. The FHLBank System's largest holder of capital stock in 1997 was Washington Mutual Bank of Stockton. California. with capital stock valued at $634 million.

For a copy of the Federal Home Loan Bank System 1997 Financial Report, contact Joseph A. McKenzie at (202) 408-2845.

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FHLBank Act because it enables the FHLBank of Chicago to carry out its housing finance mission.

Additionally, the court rejected all procedural challenges, finding that the Finance Board did not violate any federal administrative law requirements in promulgating the investment provisions of its Fiscal Management Policy, or in approving the MPF.

"This court must look at the statute as a whole and the intent of the drafters instead of being restricted by the literal wording of Congress in any single provision in isolation," Judge Sparks stated.

Resources

"HUD's Consolidated Plan: An Action Guidefor Involving Low Income Communities" is a new publication by the **Center for Community Change.** The publication is an introduction to the plan and provides and overview of all parts of the consolidated-plan process. The publication costs $15 and can be ordered from the Center for Community Change, 1000 Wisconsin Ave. NW, Washington DC 20007, or by calling (202) 347-0519

The cover story of the winter 1998 issue of **The Ford Foundation Report** describes a new project called *"Downpayments on the American Dream"* that is testing individual development accounts. For copies, contact The Ford Foundation, 320 East 43rd Street, New York NY 10017 or visit its website at *www.fordfound.org.*

The Corporation for Enterprise Development has published a working paper titled *"20 Promising Ideas for Savings Facilitation and Mobilization in Low-Income Communities in the U.S."* The report is based on a July 1, 1997, meeting that brought together 32 leading experts on development finance, economic development, and international microfinance. The experts discussed creative and promising ideas for promoting savings in areas of research and education, applications and community-based initiatives, and policy. For more information. contact Ray Boshara at (202) 408-9788.

"The Border Colonias Region: Challenges and Innovative Approaches to Effective Community Development," a new publication from the **Housing Assistance Council,** presents detailed case studies of successful approaches to improving housing and infrastructure in the *colonias.* The *$5* publication also includes a background section outlining challenges faced by colonia residents. To order, contact the HAC at (202) 842-8600 or visit *www.ruralhome.org* for an order form.

"Principles and Practices of Community Development Lending", a publication of the **Federal Reserve Bank of Minneapolis,** provides lenders with information to make safe, sound, and profitable community development loans. The book also includes a model that leads lenders through the loan evaluation process step by step. For more information, contact the Community Affairs Department at the bank at (612) 204-5074.

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