FEDERAL HOUSING FINANCE BOARD

Building Blocks

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Required by New Legislation

Board Approves New Rule on Capital Standards for FHLBanks

The Federal Housing Finance Board approved on May 22 a proposed rule that would implement a new capital structure for the Federal Home Loan Banks, as required by the Gramm-Leach-Bliley Act. The rule would replace the existing "subscription capital" structure with a more modern, flexible, risk-based capital structure for all of the FHLBanks.

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 bears no relationship to the risks posed by its investments or business practices.

The subscription capital structure has caused the FHLBanks to become substantially overcapitalized in relation to the risks they face. The amount of excess capital was a factor in the increase in the amount of arbitrage investments made by the FHLBanks, such as investments in money market instruments or mortgage-backed securities that do not advance the housing finance and community lending mission of the FHLBanks. The substantial amount of the non-mission investments held by the FHLBanks collectively, though diminishing in recent years as a percentage of their assets, has been the subject of much criticism from the Administration and the Congress, and was one issue that the Congress intended to address by reforming the capital structure and other aspects of the FHLBank System.

On November 12, 1999, the President signed the Gramm-Leach-Bliley (GLB) 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 over a period of several years 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 government-sponsored enterprises. The

(See **STANDARDS**, page 2)

MPF Becomes Permanent Program

FHLBanks' Assets, Activities Enhanced by New Rule

The Federal Housing Finance Board approved on June 30 a final rule that authorizes the Federal Home Loan Banks to acquire assets of their members through risk-sharing arrangements. The rule provides full regulatory authorization to mortgage purchase programs, such as Mortgage Partnership Finance (MPF), which heretofore have been authorized as "pilots" only. It effectively eliminates the cap on the amount of mortgages purchased under such programs.

"This rule is a vote of support for innovation in the FHLBank System, authorizing and identifying investment activities by the FHLBanks that enhance the

(See **RULE**,page 4)

(**STANDARDS** from page 1)

GLB Act provides for a transition period to the new capital structure of up to approximately 5 years, during which time the prior capital provisions are to remain in effect. The GLB Act requires the Finance Board to promulgate uniform capital regulations for the FHLBanks no later than November 12, 2000.

CAPITAL REQUIREMENTS

The proposed rule reflects the requirements of the Gramm-Leach-Bliley Act that: each FHLBank maintain a ratio of total capital to total assets of at least 5 percent; and that each FHLBank may weight its permanent capital (the amount of Class B stock plus retained earnings) at 1.5 times paid-in value as long as its total capital including such weighting is not less than 4 percent of its total assets.

Total capital is defined as:

- an FHLBank's permanent capital (defined below), plus:
- the amounts paid-in by members for Class A stock (which is redeemable on 6 months written notice);
- any general loss allowance, if consistent with Generally Accepted Accounting Practices (GAAP) and not established for specific assets;
- other amounts from sources determined by the Finance Board as available to absorb losses.

Permanent capital is defined in Gramm-Leach-Bliley as the amount paid-in by members for the Class B stock (which is redeemable on 5 years written notice), plus the amount of an FHLBank's retained earnings, as determined in accordance with GAAP. For purposes of meeting the 5 percent leverage ratio, the amount paid-in for Class B stock and the amount of retained earnings are multiplied by 1.5, which can result in an effective leverage ratio of 4 percent.

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 FHLBank is subject. Regarding credit risk, the proposed rule would provide a regulatory framework that would assess capital charges based on the extent of the underlying credit exposure. Investments would be assigned a risk factor, weighted according to estimated risk exposure. For example, FHLBank advances, which are fully collateralized, would have a minimal risk factor. Under the proposed 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 proposed rule also imposes an operations risk capital requirement.

STOCK ISSUANCE

The proposed rule would permit each FHLBank to issue either Class A stock or Class B stock, or to issue both Class A and Class B stock. Whatever classes 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 proposed rule would define the essential characteristics of both Class A and Class B stock. 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. The Finance Board is proposing that Class A stock have a par value of $100 per share, be issued at par value, and pay a stated dividend that has a priority over the payment of dividends on Class B stock.

The characteristics of Class B stock differ from those of Class A stock. As required by the GLB Act, Class B stock is redeemable in cash and at par value on 5 years' written notice to the FHLBank. The Finance Board is proposing that Class B stock have a par value that is determined by the FHLBank and is included in its capital structure plan. Class B stock would be issued at a price determined by the FHLBank, which could be different from the par value. The Finance Board is proposing this provision so the FHLBank has flexibility to convey greater permanence on Class B stock by setting par value below the issue price. The Class B stock would also confer an ownership interest in the retained earnings of the FHLBank upon payment of the issue price purchase by a member. This provision is required by the GLB Act and is consistent with other forms of permanent capital in the marketplace.

Under the proposed rule, no member institution would be allowed to exercise more than 20 percent of the voting rights on the board of an FHLBank in any election, but a FHLBank may establish a lower percentage limit in its capital plan. The capital plan should provide for representation on the board on the directors for smaller members that own Class B stock. In addition,. In addition, no member institution could hold more than 40 percent of any class of a FHLBank's stock.

CAPITAL STRUCTURE PLANS

As mandated by the GLB Act, the proposed rule requires the FHLBanks to establish capital structure plans, which must be submitted to the Finance Board for approval within 270 days of the publication of the final capital 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' capital investment or annual membership fee, and describe how the FHLBank intends to solicit its members for voluntary purchases of its capital stock.

Also, the capital structure plan must specify the operating total capital and operating leverage and risk-based capital ratios at which the FHLBank intends to operate, establish criteria for transfer of bank 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.

The Federal Home Loan Bank System: Tomorrow's News

(Federal Housing Finance Board Chairman Bruce A. Morrison was the keynote speaker at the FHLBanks' Directors' Conference in Washington, D.C. on June 7. The following are excerpts of his remarks.)

My passion for what can be done by this System is not only undiminished; rather; it has grown in the 5 years I have been here. I came faced with the question asked by many then, and still asked by some today, "Is this a System that's yesterday's news? Should it be abolished?" I did not know the answer to that question when I took on this job, but I am quite clear on the answer as I leave. The System has the capacity to be even more than it has been in a 68-year history of great accomplishment. It is not at all yesterday's news. It is tomorrow's news, if only we take advantage of what's on offer.

What makes the System so special? One factor that's been talked about a lot in Washington recently, and I guess a lot on Wall Street, is the implied guarantee. It's a little bit of magic that developed over the history of the GSE in this country. Quite frankly, if those who are talking about this issue on Capitol Hill and Wall Street succeed in making the guarantee go away, it won't be in anybody's interest.

The implied guarantee does not arise, contrary to what some believe, through an empowerment of the Secretary of the Treasury to buy a few billion dollars of System debt. Rather it arises from the importance of what the GSEs do -- make housing more affordable -- and how big they are. They have a central economic role in financing the housing that all politicians want for all of their constituents. And they've become too big to fail.

I'm not happy about what I see reflected in discussion on the Hill on this subject. It's legitimate to discuss how the GSE benefit ought to be managed for the benefit of the people. But it appears that a lot of people have entered this discussion without a destination in mind, without clarity about what they're trying to accomplish and what they're not trying to accomplish.

There really is a huge fork in the road on this question. There is the economist's view, or what might be called the Federal Reserve's view, or on some days the Treasury's view. That view holds that government backing, government assistance, government subsidy -- use whatever term you like -- is wrong. That view says that we shouldn't favor housing over other economic activities; the market should decide; credit allocation to housing is inefficient, and we should get rid of it. That's the fork in the road that takes you to privatization: take the subsidy out; take the benefit out; make sure you wring the implied guarantee out of the System.

I don't happen to think that's a particularly good answer. I think most people in office who make these decisions would say, "Well, that's all very nice, but exactly which activities is that investment going to flow to instead of housing, and who is going to really benefit from that? I know who's getting the benefit from the housing assistance and housing subsidies. I know that that assistance makes my community stronger." I know that people are really invested in what that housing

(See **SPEECH**, page 4)

President Clinton Nominates New Member

Morrison Resigns Chairmanship; Returning to Private Sector

Federal Housing Finance Board Chairman Bruce A. Morrison resigned on July 4 his position as the chairman and a director of the Board of Directors of the Federal Housing Finance Board.

By resolution, FHA Commissioner William C. Apgar is successor to all the Finance Board's authorities and powers.

Mr. Morrison will be joining GPC/O'Neill as vice chair and will be working in the firm's Washington D.C. office. GPC/O'Neill is the U.S. division of GPC International, a worldwide strategic government relations, pubic relations and communications consulting firm.

Mr. Morrison's departure will leave the five-member Finance Board with two serving members, Apgar, and J. Timothy O'Neill. Four nominees, O'Neill, Douglas Miller, Franz Leichter, and Allan Mendelowitz, are awaiting confirmation by the Senate.

Mr. O'Neill was renominated to the board by President Clinton in 1998 and continues to serve as a board member though his term expired in 1999. Mr. Miller and Mr. Leichter were nominated by the President in 1999.

Mr. Mendelowitz, an economist and federal government official, was nominated by the President in June.

Mendelowitz has served as executive director of the U.S. Trade Deficit Review Commission since October 1999. Earlier in 1999, he served as vice president of the Economic Strategy Institute. From 1996 to 1998, he was executive vice president of the Export-Import Bank of the United States. Prior to that he served for 15 years at the General Accounting Office as managing director for international trade, finance and economic competitiveness.

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brings to communities. And I think that kind of knowledge is why the consensus exists politically for having this intervention in the market.

Of course, the intervention is hardly unique. We intervene all the time through our tax system. Most of us, I think, believe that a balance between the marketplace and government intervention is healthy democratic capitalism, as opposed to cowboy capitalism. We make normative judgements about how the market is going to shape our society.

To repeat, then, one fork is the road to privatization. The other fork we can take is to continue the implied guarantee but with greater thought to managing the benefit and the risk. We should be sure that the benefit is parceled out in a way that passes through the maximum amount to the public. We should be sure that the system that's used to give subsidies for housing actually ends up producing more and better housing for the American people, using the magic of the marketplace to make that distribution efficient. That is the essence of the GSE model. It's also the goal of mission regulation, by the way.

Then there's also, of course, the concern about risk. If debt is going to be issued with an implied guarantee then, in a sense we're all winking and nodding, because we all know if there were a problem the implications become real and some sort of intervention would be required.

Let us focus on the two factors that are on the other side of the equation, which is to maximize what we are getting in terms of passing through benefits to the public and, at the same time, deal with how much risk, how much debt, we are willing to see taken on.

Are there ways to deal with that? I think so and that's why I like the Federal Home Loan Bank System so much. It is not that it isn't motivated by capitalist instincts. The members and stockholders are market driven, stockholder-owned institutions. But it's a cooperative. The essential element of the cooperative is that all of you who are elected directors represent member institutions in the business of extending credit for housing and economic development. Your reason for being in the Bank System is to provide better funding for doing that business.

> "Mission regulation . . . is inherent in the concept of a GSE."

Your stockholders want you to maximize your profit as you do that business, and, therefore, you are just as voracious about trying to increase your spreads as any other business. But you're all in competition with each other out there in the market, and so the vast majority of the benefit passes through to the public through that competition.

You can't take more spread than your neighbor. Your neighbor is going to be taking off that basis point to beat you to the business, and you are going to take another basis point off to beat your neighbor to the business. That's how competition works, and that's what passes the benefit through.

That dynamic does not exist with Fannie and Freddie, because their shareholders couldn't care less whether they make housing loans or aardvarks. All they care about is the stock price. What is the payout? They're investors, not cooperative owners, and that is a big difference.

If I had control of such decisions, I'd never create a GSE that wasn't a cooperative, because I think the cooperative form is the best way -- much better than any regulatory oversight -- to pass through the benefit to the public using what the market does best, competitive pricing. That's why we use markets to distribute the public benefit, and that's why this kind of a system is so good.

What are some other concerns?

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(**RULE**, from page 1)

lending capacity of their members," said Finance Board Chairman Bruce A. Morrison. "In light of the impending new capital standards for the FHLBanks, this rule informs investors about the regulator's preferences before purchasing the stock. It also lets the FHLBanks know what types of core mission activities to include in their strategic business and capital plans."

Acquired member assets (AMA) chiefly include whole mortgage loans originated by or held by an FHLBank member institution, provided there is a risk-sharing arrangement in which basically the member manages the credit risk and the FHLBank manages the interest rate risk.

The rule also specifies which FHLBank activities in addition to AMA qualify as core mission activities (CMA), including such activities as: advances to members, standby letters of credit, targeted investments that support affordable housing and economic development activities and investment in small business investment corporations.

The final rule follows a proposed rule published for comment May 3. Similar to the proposed rule, the final rule states that, going forward, government-insured AMA such as FHA loans can count as CMA in an amount up to one-third of the total AMA held by an FHLBank, but adds some flexibility in the calculation of the percentage that was not in the proposed rule. These provisions in the rule aim to encourage more participation in the conventional market and true competition with the secondary market.

"This is a landmark in mission regulation of government-sponsored enterprises," Morrison said, "because, for the first time, we are looking at the whole balance sheet for compatibility with mission."

The final rule does not restrict beyond current law or regulation the FHLBanks' investment in non-CMA assets such as mortgage-backed securities.

The rule takes effect immediately upon publication in the Federal Register.

Finance Board Approves Final Rule On Expanded Collateral for FHLBank Activities

The Federal Housing Finance Board approved on June 5 a final rule implementing provisions of the Gramm-Leach-Bliley (GLB) Act that enable Community Financial Institutions (CFIs) to pledge additional classes of collateral and increase the amount of other real estate-related collateral that can be pledged for Federal Home Loan Bank advances.

The final rule sets guidelines for the FHLBanks for accepting new types of collateral that can be pledged by CFIs (FDIC-insured institutions with less than $500 million in assets) to include: small business loans, agriculture loans, or securities representing a whole interest in such loans. The rule requires a FHLBank to demonstrate that, before accepting the new collateral, it has the proper procedures in place to properly value and dis count the collateral and manage the risks associated with it.

"This rule is critical to the funding needs of many community banks that are members or potential members of the FHLBank System," said Finance Board Chairman Bruce A. Morrison. "Since more community banks will be joining the FHLBank System and existing members will be able to borrow more, we hope to see a significant increase in lending in underserved areas."

The final rule follows a proposed rule for comment that was published May 8. In response to suggestions by commenters, the definition for small business loans, small farm loans, and small agri-business loans that can be used as collateral for advances by a CFI is less restrictive than the proposed rule.

While the proposed rule set dollar limits on the loans, the final rule defines small business, small farm, and small agri-business loans as eligible to be used for collateral as long as they are within the loans to one borrower limits of a CFI. Combined with the asset limit for CFIs, this approach will restrict the size of such loans without setting a specific dollar limit or requiring burdensome documentation.

The final rule also implements a provision in GLB that removes a limit for all members on the amount of advances that could be secured by real estate-related collateral other than mortgages (such as home equity loans and commercial real estate loans). The amount had been capped at 30 percent of a member's capital. The rule takes effect 30 days after publication in the Federal Register.

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Clearly if you chose privatization, you have to accept that privatization means loss of public mission -- not evil, just loss of public mission. If, on the other hand, one wants to preserve the system of directing resources toward housing, there is a public mission and with that there is an oversight responsibility.

Mission regulation has got to be the least popular thing that we do at the Finance Board, but it has to exist. That doesn't mean it has to come in any particular form or be executed by any particular method, but it is inherent in the concept of a GSE. I find that it is the least accepted tenet of mine about GSEs. Every time I turn my back somebody is trying to take away mission regulation, whether it's a draft bill on the Hill, or an ACB position paper. I understand that there's a lack of consensus on that point.

But, first, please think about the fact that if you're not choosing "private" you're choosing "public/private." And the public piece is about delivery of a benefit that the government is creating by standing behind the implied guarantee of the debt.

Second, the real thing that I think Treasury should start thinking about in a constructive way if they're concerned about the exposure of the public is how to deal with "too big to fail." They should not be doing things to take the markets to higher prices; that doesn't do anybody any good.

> "What we can do is focus on the 'too big' part and make it smaller."

The first thing to do is stop kidding ourselves that we could walk away from the accumulation of over $2 trillion in debt if there were trouble. That's 20 percent of the debt outstanding in the entire economy, and we can't just walk away.

What we can do is focus on the "too big" part and make it smaller. Frankly, this System gets better grades than Fannie or Freddie on the question of too big. But you have heard before what I am about to say, "Arbitrage is an issue."

The ideal GSE doesn't have a bigger balance sheet than is necessary to perform its function for its constituency. The natural way in which all managers think of their enterprise is that bigger is better, and we tend to compensate managers based on growing the enterprise.

With respect to the Federal Home Loan Banks, the issue of size is what the capital planning process is all about. How much of your capital do you want to invest in a Federal Home Loan Bank as commensurate with the benefits that your business receives? If the answer is none, then you should leave the System. You shouldn't expect somebody else to

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capitalize a System that's a cooperative and exists to benefit your business. No one is forcing you to stay.

If you're staying, which I think most of you will because of the benefits, you should expect to capitalize the System and capitalize the risks of the System. There's nobody else to do it. Uncle Sam is not the appropriate person to put up the capital. He's putting up the implied guarantee, and we should keep him in that game, but the capital is private. That's the whole theory of a GSE.

The decision of how much capital is it worth it to your business is a lot like the decision-making process if you were setting up a specially powered affiliate that could do capital markets transactions better than you could do through your existing company. You'd be asking the question, "How much capital is it worth to commit to this affiliate?"

That's what this Federal Home Loan Bank System is. It is your capital markets affiliate, and it has more strength than any one of your institutions could create by themselves. The proposed rule on capital was written fully open to a real, hard-nosed look at those economic questions. If people sleep through this they have only themselves to blame. This is the moment, and it's a moment when public and private interest come together at the point when you decide that there's no need for this balance sheet to be any bigger than what you need.

It's never been the point of view at the Finance Board that there doesn't need to be flexibility with investments in order to deal with the ups and down of the market. It has been the view, however, that the bulk of the energy of the System and the bulk of the capital of the System should support assets that help members directly -- not indirectly by giving you a dividend -- but directly by giving you products that help you be a better competitor in the marketplace. That's what the discussion of arbitrage and FMMA and CMA is all about, and that's <u>all</u> it's about.

Our mission regulation isn't nearly as constraining as some of the critics say. Most of what's now proposed in CMA is in fact without any teeth, except for its usefulness in the planning process. In other words, the Finance Board is specifying what we think are the most productive assets, and we want you to think about maximizing them in the planning process.

We could go back to FMMA and its percentages, but I frankly don't think that ever will happen if people take on the capitalization challenge and the business planning challenge as I've outlined it. I don't think anybody will feel the need to set a specific ratio if that's done.

> "[W]e can . . . continue the implied guarantee but with greater thought to managing the benefit and the risk."

It will be a different story if people continue to say that what they really like about the Bank System is that it's a great leveraged return, and the more MBS the merrier. That's like having a leveraged mutual fund -- great return, no risk, borrow low, invest a little higher, walk away with a check at the end of the day. Some people feel that way. They don't say it to me, but they certainly feel that way about the System.

If we really want to have a sensible conversation, we need to talk about the balance sheets of all of the GSEs. It's certainly fair for the Federal Home Loan Banks to say that until somebody does something about Fannie and Freddie and their activities, what right do we at the Finance Board have to keep whining? That's a fair perspective.

But there's another perspective: the Banks can be the example of the model GSE doing its job with less risk to the tax payers and more benefit to the public. Some of you may be glad that every time they write an article about what's been going on on the Hill the criticism is of Fannie and Freddie's debt. Nobody ever mentions the Federal Home Loan Banks, and some people say that's great; we're flying under the radar. I can tell you that your debt isn't under the radar. You're getting hit by the same hammer as Fannie and Freddie. It's just that for now nobody knows you even exist. That's partly because you don't have traded equity, but it's also partly because of the way that the Bank System has performed its public relations function to keep under the radar, which is not necessarily in your interest.

People rail against Fannie and Freddie, and then they beat up the Federal Home Loan Bank substantively; that's certainly the way Treasury plays this. That's Treasury's modus operandi, I can tell you, after five years of meeting with them. They call it the "weak caribou" theory.

When you go after a herd, you don't go after the lead caribou. You get the straggler. After you get the straggler, you're a little stronger from that good meat. Then you can go for the next caribou.

It's time for the Bank System, I think, to weigh in with its real potential to be different and better. That's what the capital re-structuring is all about, and that's the opportunity I hope you will see in it.

The combination of things that has happened over the last few years -- the devolution of management in every sense to the Banks, the granting of new powers for membership and collateral, the new capital structure, the new product opportunities such as acquired member assets and letters of credit -- represent a huge business opportunity for the Banks. It's really up to you. It's not up to the regulators whether you make use of the business opportunities.

The capital system is the template for a plan that takes advantage of the new opportunities. It's a huge opportunity. It's more work, but it's more yield. It's more benefit, and not just for the public that gets the derivative benefit, but in terms of better business opportunities for the Banks as businesses and for the members

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Finance Board Approves Final Rule Devolving Debt Issuance to FHLBanks

The Federal Housing Finance Board approved on June 5 a final rule that devolves to the FHLBanks the authority to issue consolidated obligations (COs) through the Office of Finance. Currently, the Finance Board issues the FHLBank System debt, also through the Office of Finance. The technical change will have no substantive effect on the debt issuance process or on the joint-and-several liability of the FHLBanks to bondholders.

"The Finance Board should not be involved as both the issuer and the regulator for the Federal Home Loan Banks," said Finance Board Chairman Bruce A. Morrison. "This action provides the FHLBanks greater autonomy over the management of their business and removes the Finance Board from involvement in management functions, as is appropriate and the case with other regulators."

The final rule also requires the Office of Finance to prepare the combined FHLBank System annual and quarterly financial reports as part of the CO issuance function.

The rule also establishes a new capital leverage standard for the FHLBanks, changing from a liability-based limit to an asset-based limit. The Gramm-Leach-Bliley Act requires the FHLBanks to be subject to asset-based leverage limits and risk-based capital requirements. When implemented, the new risk-based capital regime will provide an additional safeguard to the FHLBank System and its bondholders by requiring the FHLBanks to hold capital in proportion to the risks they assume.

The ratings requirements in the final rule reflect current practice and will impose no new costs or burdens on the FHLBanks, since each of the FHLBanks now has an AAA long-term issuer credit rating.

The final rule differs from the proposed rule published January 4 of this year in that it does not address the restructuring of the Office of Finance regarding managing joint asset activities or the size of its board of directors. Those proposals remain under active consideration by the Finance Board and will be addressed in future rule making.

The final rule was published in the Federal Register on June 7, and took effect July 1.

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as businesses. It's about remaking the mortgage markets.

If you thought about how to organize the mortgage markets in the best way, I think you would land on the acquired member assets model. We've built a secondary market based on a mortgage insurance model, transferring the credit risk to the center, so that Fannie and Freddie basically bear trillions of dollars of credit risk.

Credit risk isn't very great in mortgages, but it's still risk, and centralizing that risk hardly sounds to me like the best way to go. By setting up Fannie and Freddie in the way that we did and then setting up Bank capital in the way that we did, we conspired to make the insurance-based secondary market model dominant.

What we've been doing with acquired member assets, with mortgage purchase programs, is driving the train back in the other direction, trying to undo the capital disadvantage that the recourse model now faces. Recourse is a better model for secondary markets. Why? Because it puts the risks and rewards in the right places.

It's not an insurance system. People who do the underwriting get the benefit from good underwriting. It's got the right economic discipline.

If you want to take more risk, you can take more risk under the recourse model, but you bear that risk and you capitalize that risk. You charge for that risk. You really can't do that the way the secondary market operates today with guarantee fees that have more to do with the size of the transaction than the risks of the underwriting.

> “This System can go from yesterday's news to the leading edge, to the third way home.”

On the other hand, when you get that risk back out there to 7,000 originators in the Bank System, you also spread the risk and diversify it even further through all kinds of insurance and credit derivative structures. You pass that risk back out, rather than draw it to the center.

If the Bank System succeeds in developing this model, I predict that within a decade the entire mortgage market will be driven in that direction. The pricing will be better and any sensible person in a government role will be saying, “Why are we letting Fannie and Freddie have $2 trillion of risk when we can push it out into the markets so much more constructively by a properly functioning recourse scheme?”

There's a huge opportunity on offer here. This System can go from yesterday's news to the leading edge, to the third way home -- a recourse conduit structure that brings the risks to the right places through the right mechanism with the right discipline and lower risk all around because it deploys a better risk management structure.

RESOURCES

"Housing America's Working Families" a publication of the **Center for Housing Policy**, an affiliate of the National Housing Conference, reports that 14 percent of moderate-income working families have critical housing needs. More than half of these families are homeowners; most spend more than half of their income on housing while 21 percent live in seriously substandard homes. Copies of the report are available free from the NHC by calling 202-393-5772.

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"Housing Our Elders: A Report Card on the Housing Condition and Needs of Older Americans" is free from **HUD** at *www.huduser.org*, or for $5 by calling 800-245-2691.

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"State and Local Affordable Housing Programs" A Rich Tapestry" includes descriptions of more than 100 programs, and is available from the **Urban Land Institute** for $39.95 for ULI members and $49.85 for nonmembers by calling 800-321-5011.

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"Combining Funding Sources for Rural Housing Development," published by the **Housing Assistance Council**, reports success stories of nonprofits that have developed affordable housing while balancing the demands of various funding sources. For copies call the HAC at 202-842-8600, ext. 141.

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"Catching the Brass Ring" by the **American Planning Association** examines how to acquire military property for community use. Call 312-431-9100 for more information.

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"The Forgotten Americans -- Homelessness Programs and the People They Serve" is a recent report from **HUD** available at *www.huduser.org* or by calling 800-245-2691.

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"An Annotated Bibliography of Faith-Based Community Economic Development" is a comprehensive list of useful books, articles, videos, and Internet sites of interest to those involved in faith-based community development published by the **National Council for Community Economic Development**. To order, contact NCCED at 202-289-9020.

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"Rural Rental Housing" is the **Housing Assistance Council**'s 1999 State of the Nation's Rural Housing Report. For more information call 202-842-8600.

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"Rental Housing Assistance -- the Worsening Crisis" is a report from **HUD** to Congress on worst-case housing needs. See report at *www.huduser.org*, or call HUD at 800-245-2691.

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"Models That Work," published by **America's Community Bankers**, tells the stories of 50 partnerships across the nation that are working to make the dream of homeownership a reality for American families. For information on the report, contact ABA at 202-857-3101.

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"Where Banks Do Business: Small Business Lending Patterns in the Chicago Area, 1996-1998" is new report form the **Woodstock Institute**. For more information, call 312-427-8070 or visit the Internet at *www.woodstockinst.org*.

Managing Director to Leave

Federal Housing Finance Board Managing Director William W. Ginsberg has announced he is leaving the agency in August to return to his hometown of New Haven, Connecticut, to head up a community foundation.

Mr. Ginsberg became Managing Director of the Federal Housing Finance Board April 16, 1997. As Managing Director, Mr. Ginsberg serves as the Finance Board's chief operating officer in charge of the day-to-day operations of the agency.

He will assume the position of president and CEO of the Community Foundation for Greater New Haven, which has assets of approximately $225 million and has been one of New Haven's key civic institutions since 1928.

Prior to coming to the Finance Board, Mr. Ginsberg served as Assistant Secretary for Economic Development and Chief of Staff at the U. S. Department of Commerce.

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