

Testimony of Norman B. Rice
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Before the Federal Housing Finance Board
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Mr. Chairman and Board Members, I deeply appreciate the opportunity to testify today about the new capital plans. As the first and only district bank to navigate through this process, I believe I can offer a unique perspective on this topic. In my brief comments, I would like to focus on the key lessons learned along the way, and offer some observations on the evolving nature of both the Finance Board and the district banks in light of this capital transition.

First, I would like to turn to the top four lessons learned as the Seattle Bank moved through the approval process.

Key lesson learned number one: leadership matters.

Chairman Korsmo stepped into an agency that had been severely buffeted by uncertainty and changing leadership for quite some time. To your credit, Mr. Chairman, you immediately recognized that your number one job was to complete regulatory implementation of the capital provisions of the Gramm-Leach-Bliley Act. You benefited from some excellent work in the rulemaking process under past leadership and by staff. By setting clear expectations and deadlines, you jumpstarted a stalled process and, against all odds, you enabled us to carry the ball over the goal line in Seattle. Your decision to invite a team from the Seattle Bank to face-to-face discussions with your staff proved to be a tactical breakthrough, enabling us to find a meeting of the minds quickly.

The Seattle Bank is now on the road to actual conversion on June 30, 2002. Thank you, Mr. Chairman. And, thanks to all of the Finance Board members who have been actively engaged and helped shape this process.

Key lesson learned number two: the Federal Home Loan Bank System has never been stronger.

Congress directed us to embark on this process to assure that this Bank System remain safe and sound. Prior to the Gramm-Leach-Bliley Act, the consensus was that this system had more than enough capital – in fact, by most accounts we were overcapitalized. Upon conversion to the new capital plans, we will still have more than enough capital and it is now more permanent. As an example, post-conversion, the Seattle Bank will have at least \$1.2 billion more capital than required to meet the new risk-based capital requirements.

So, right off the bat, we know that remaining issues are not about sufficiency of capital. The remaining issues represent a difference of personal opinion over philosophy and business choices. Some district banks may choose to tie stock ownership very closely to member business activity and others may choose otherwise. Congress was not prescriptive on this point. They were prescriptive on the amounts and kinds of capital at district banks and all district banks must clear that hurdle.

The most fundamentally important issues raised by Congress have been addressed. We have more than sufficient capital – more than is required for the two other housing GSE’s – and there is greater permanency of our capital base.

Key lesson learned number three: individual district bank circumstances must be allowed to drive capital plans.

There are two hallmarks of the Federal Home Loan Bank System – cooperative ownership and regionally based, independently owned district banks. There are some individuals that bristle at the lack of central coordination and the messy nature of it all. But Congress intended to create this creature to hold us accountable to our members and to assure that we are sensitive to the unique markets and communities we serve. Congress did not choose a cookie-cutter approach and such an approach would not work if we are to meet our public purpose.

In the context of the new capital plans, that meant the Seattle Bank was able to craft a plan to meet our specific circumstances and specific business and strategic goals. Our capital plan reflects the expectations of our members, the needs of our communities, and our institutional history.

In the Seattle context, we moved very quickly because the new capital plan was a very effective tool to drive our larger strategic business plan. It generates substantial new financial value thus enabling us to tackle a number of important issues.

The additional financial value will be passed on through lower pricing on our advances and other products. Thus more financial value will be passed through to consumers and to our communities. It means the Seattle Bank will be more competitive in the marketplace.

The additional financial value convinced our shareholders that the time was right to rein in excess stock – a chronic issue in Seattle since FIRREA. That means our capital will be deployed directly to support business activities that advance our public purpose rather than deployed solely to assure sufficient financial returns to shareholders. In the Seattle case, we expect to use our capital to support growth in our Mortgage Purchase Program.

This is the Seattle story. It will be different at each of our sister banks. A cookie-cutter approach driven by some vague notion of “commonality” would have denied members the right to craft their own future. There is sufficient commonality to guarantee safety and soundness because of the minimum capital requirements and the new risk-based capital requirements.

Key lesson number four. Keep in mind the law of unintended consequences.

It was not surprising to encounter a number of tough issues at the last minute in the approval process. That is the price you pay for going first.

But I would caution that shoot-from-the-hip, last minute rulemaking more often than not comes back to haunt you. It is widely known that we had a difference of opinion over the capital sufficiency requirement. To the Finance Board’s credit, we were able to have an

open and respectful dialogue on this issue. Neither side fully prevailed and we were able to find a middle ground that we can make work.

The pragmatist in me tells me to let sleeping dogs lie on this issue. But, I remain convinced that this rule is driven mostly by a desire for a cookie-cutter search for commonality and not by any legitimate concern for safety and soundness. I appreciate that the Chairman has publicly stated that he remains open to discussion on this issue, and I would urge that the dialogue continue. And, should it be resolved differently, you can count on the Seattle Bank coming back with amendments to its capital plan.

Those are the biggest lessons learned from Seattle.

I would like to close with a final observation concerning the evolving relationship between the Finance Board and the district banks. This relationship continues to change from FIRREA through the GLB Act as Congress attempts to clarify in statute the proper arms-length relationship between regulator and regulated.

I believe this is the single most important issue shaping the future of the Bank System. The success of the Seattle Bank, and all district banks, hinges on the public's confidence in the quality of regulation to assure the continued safety and soundness of the Bank System.

Continued progress on this issue requires a focus on three points. First, the district banks must understand and acknowledge that an informed, engaged and active regulator ultimately is in our best interest. We need to do everything in our power to build a trust relationship, to welcome fair and reasonable regulation, and to help build the credibility of this agency.

Second, the Finance Board must continue to sort out legitimate regulatory responsibilities around safety and soundness from an historical institutional tendency to intrude in business decisions at the district bank level. These banks are cooperatives and they are privately owned, competing within the private market. Within the bounds of safety and soundness, the district banks must have the power to innovate and to create if we are to respond to the market and meet the needs of our members and communities. That means individual boards of directors and their shareholders must have the right to make decisions and take chances, even if the regulator or other district banks may disagree.

Third, I mention the need for trust. Trust is something you build not just talk about. You demonstrate it by your actions. Mr. Chairman, you have demonstrated through your actions that you mean what you say. It is a great start and my hat is off to you.

Again, thanks for the opportunity to testify today.