

FEDERAL HOUSING FINANCE BOARD

OPEN MEETING

Thursday, September 12, 2002

1777 F Street, N.W.
Second Floor Boardroom
Washington, D.C.

The Board meeting convened, pursuant to
notice, at 10:11 a.m.

BEFORE:

- JOHN T. KORSMO, Chairman
- J. TIMOTHY O'NEILL, Director
- FRANZ S. LEICHTER, Director
- JOHN C. WEICHER, Director
- ALLAN I. MENDELOWITZ, Director

ALSO PRESENT:

- ARNOLD INTRATER, General Counsel
 - ELAINE L. BAKER, Secretary
- AGENDA

ITEM

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Patton Boggs, LLP

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P R O C E E D I N G S

CHAIRMAN KORSMO: I'll call this meeting of the Federal Housing Finance Board to order. With most Americans yesterday, the Federal Housing Finance Board paused to reflect on the events of September 11 of last year and to recognize our nation's continuing commitment to freedom. I thought it might be appropriate for us to acknowledge again on our agenda today what we all remembered so passionately yesterday, and I would ask as we begin our meeting that everyone please join me for a brief moment of reflection in memory of those who were murdered and those who sacrificed themselves for others.

[Moment of silence.]

CHAIRMAN KORSMO: Thank you very much. We have a full agenda today, so let's get started. First item on our agenda are the proposed standards of conduct held over from last month's board meeting. The General Counsel of the Department of Housing and Urban Development suggested language that helps clarify the proposal to make certain that these rules as we propose to adopt them apply to Secretary

Martinez and to Director Weicher's activities only as related to their Finance Board responsibilities.

John, I appreciate your raising the issue last month. These new standards are so central to the board's operations that it is important to make certain we do them completely and correctly and I appreciate you pointing out this problem last month and assisting in getting it ironed out.

These proposed standards of conduct address the most basic, most serious relationship we deal with at the Federal Housing Finance Board, the relationship of the directors, officers and staff to the Federal Home Loan Bank System.

Their adoption, I believe, will put the Federal Housing Finance Board on record, on public record, as supporting the highest standards of conduct for agency directors and staff, minimizing any ambiguities in how we regulate the Federal Home Loan Bank System.

This proposal grows out of the changing relationship between the board and the Bank System, starting with passage of FIRREA in 1989 which

replaced the Federal Home Loan Bank Board by creating the Federal Housing Finance Board.

Passage of Gramm-Leach-Bliley ten years later was the next and obviously most significant step fundamentally distinguishing the Finance Board from the 12 Federal Home Loan Banks.

For example, Congress deleted the Finance Board's authority to set compensation for presidents and other bank employees, to name the chairman or vice chairman of the boards of directors, or determine interest rates or dividends.

At the same time, however, Congress demanded that banks implement modern risk-based capital structures while giving them the authority to run their day-to-day operations without involvement by the Finance Board and business decisions or administration.

After following the map for three years, we finally crossed the border into that new territory in July with approval of the capital plan for the Federal Home Loan Bank of New York, the 12th and final capital plan approval.

As I observed in New York, the Finance Board is no longer the senior partner in the operation of the Federal Home Loan Banks. The board representing the public interest is now the arm's length regulator for the safety and soundness of the system.

This fundamentally different relationship puts new demands on the Finance Board. For example, it became abundantly clear that we had to strengthen the board's supervisory functions, increasing staff and trying different approaches toward bank examinations. The reorganization announced last month helps us to achieve those goals, I believe, while reinforcing our ability to carry out the affordable housing mission.

In my early days as chairman, it also occurred to me that the new Board-System relationship must also shape our activities as board members and by extension the activities of board staff.

To represent the public interest, we must always carry out our regulatory responsibilities in a manner that is fair, objective, and impartial and

clearly so. We needed a better understanding just what an arm's length relationship really is. We needed clear guidance so we can always remain above reproach in this regard.

While the General Counsel's Office is certainly well qualified to help us develop that understanding, it seemed to me the board would benefit from having a disinterested perspective backed by real expertise in the field of government ethics.

To that end, Greg Walden was contacted and agreed to help, and I'm very thankful for it. Mr. Walden is Of Counsel to the Washington firm of Patton Boggs and is a recognized authority in government ethics including laws relating to gifts, post-employment restrictions, and conflicts of interest.

He served as associate counsel to President George H.W. Bush, providing ethics advice to the White House office staff and serving as liaison to the Office of Government Ethics and the ethics officials of other federal departments and agencies.

He has testified regularly before Congress on the subject of government ethics and is the author of *On Best Behavior: The Clinton Administration and Ethics in Government*.

Mr. Walden is also an adjunct professor at George Mason University School of Law where he teaches aviation law.

Mr. Walden, thank you very much for your assistance in this project, and I'd appreciate it now if you would walk us through the proposed standards.

MR. WALDEN: You're welcome. Thank you, Mr. Chairman. At the outset, I would like to express my gratitude for the many courtesies extended me by you, by members of your staff, by Directors Mendelowitz and Leichter, and the General Counsel and members of his staff, and I very much appreciate the opportunity to be of service to you and the board.

I was asked to examine the practice of Finance Board director attendance at and participation in board of director meetings of the Home Loan Banks under the executive branch standards

of ethical conduct, general ethics principles and principles of administrative law and practice.

I also looked into the related question of the proper payment of meals and other expenses incurred by Finance Board directors when attending dinners and events held contemporaneously with the Home Loan Bank meeting.

And in doing so, it was, of course, necessary to consider the larger context of the appropriate relationship between the Finance Board and the Home Loan Banks. Indeed, any ethics study must begin with a review of the relevant and statutory provisions. My study confirmed what the chairman noted in his opening comments, that Congress intended to establish an arm's length relationship between the Finance Board and the Home Loan Banks.

Congress took the first step in 1989 in FIRREA, and ten years later put more distance between the Finance Board and the Home Loan Banks in Gramm-Leach-Bliley.

The current relationship between the Finance Board and the Home Loan Banks is essentially

the relationship between a regulatory agency and regulated entities. That the Home Loan Bank System is a government sponsored enterprise is not significant for this purpose. Similarly, the Office of Federal Housing Enterprise Oversight regulates Fannie Mae and Freddie Mac and the Farm Credit Administration regulates Farmer Mac.

So GSEs are government chartered, but they are regulated entities just the same. So what conclusions flow from the determination that the Finance Board regulates the Home Loan Banks? First, Home Loan Banks, the directors and officers, are prohibited sources as that term is defined in the executive branch wide gift restrictions.

Second, Finance Board directors and staff are subject to ethics standards in any dealings they may have with the Home Loan Banks, and among the ethics principles potentially, potentially implicated by Finance Board Director or staff attendance at Home Loan Bank meetings are three: officials shall act impartially and not give preferential treatment to any person or entity; officials shall not knowingly

make unauthorized commitments or promises of any kind purporting to bind the government; and officials shall endeavor to avoid any actions creating the appearance of impropriety.

But apart from ethics principles, I determined that Finance Board director or staff participation in a Home Loan Bank meeting poses risks to the integrity of the decision-making, both at the Finance Board and the Home Loan Banks.

Questions might arise as to ex parte communications, prejudgment or bias or recusal. From the standpoint of the Home Loan Banks, Finance Board director presence at a Home Loan Bank meeting obviously affects the nature and the tone of the discussion and the debate.

The presence of a regulator, any regulator in a meeting of the board of directors of a regulated entity is going to have some effect, even if the regulator does not speak a word.

Whatever attorney-client privilege which might apply to communications between a Home Loan

Bank general counsel and Home Loan Bank directors likely would be lost.

Of perhaps greater concern is whether the presence of a regulator effectively discourages Home Loan Bank directors from exercising fully their independent oversight, an important element of any director's basic duty of care.

My survey of ten executive branch agencies including all the banking regulatory bodies failed to discover any practice similar to the practice engaged in by Finance Board directors over the years. To be sure, any agency is subject, every agency is subject to its own statutory authority, but my study concluded the Finance Board post Gramm-Leach-Bliley now resembles the traditional regulatory body, which must maintain its independence and separation from the entities it regulates.

And thus, the Finance Board must remove itself more formally from the business and decision-making of the Home Loan Banks. Accordingly, I recommended to the chairman that the Finance Board consider prohibiting Finance Board director and staff

attendance at Home Loan Bank Board or business meetings except as may be necessary to perform his examination functions.

And I also recommended that the Finance Board clarify its gifts and travel policies in light of the conclusion that an arm's length relationship must be maintained by the board and Home Loan Banks.

In my opinion, the proposed standards of conduct under consideration today satisfactorily address all the concerns discussed in my report while they preserve a free and open exchange, which is important, between the Finance Board and the Home Loan Banks outside of Home Loan Bank Board or business meetings.

If I may, I will now proceed briefly to explain the chairman's proposed standards. Section 1 is the preamble which explains basically the relationship between the Finance Board and the Home Loan Banks and the relationship between the Finance Board and the Office of Finance.

The Finance Board by regulation, by its regulation, exercises the same regulatory oversight

and oversight functions over the Office of Finance as it does over the Home Loan Banks. So the Office of Finance stands in the same shoes as the Home Loan Banks for purposes of these standards of conduct.

As the chairman noted following discussions with the General Counsel of the Department of Housing and Urban Development, a fourth paragraph has been added to the preamble, which clarifies that these standards apply to the Secretary of HUD or his designee only to the extent that that designee is performing the duties of a Finance Board director.

Section 2 prohibits Finance Board director or staff attendance at Home Loan Bank or Office of Finance Board of Director meetings, and other business meetings of those entities.

Now, this section recognizes the duty of Finance Board directors and their staff to become knowledgeable about regulated entities, acquiring information about the Home Loan Bank System and important issues facing the System. It continues to permit meetings with Home Loan Bank directors and officers, subject to the ex parte restrictions and

provided the meeting takes place outside of an official meeting of a regulated entity convened to conduct any business of that entity.

And this section does not disturb the practice of the Office of Supervision staff who regularly attend Home Loan Bank meetings to present a report of examination or examination findings. And on infrequent occasions, to bring to the attention of a Home Loan Bank an exceptional matter.

Section 3 is a general caution about written and oral communications with Home Loan Banks and the Office of Finance.

This section makes the important point that the Finance Board exercise its rulemaking and adjudicatory responsibilities only through its board of directors acting jointly, and thus individual directors must not represent that they are speaking or give any indication that they are speaking or acting on behalf of the Finance Board absent specific direction from the board acting jointly.

Subsection (c) notes that this general caution is not intended to curtail or limit in any

way any specific authorities set forth in statute or regulation or the giving of informal advice and guidance to a regulated entity by the Finance Board staff who are responsible for providing such advice or guidance.

Similarly, subsection (d) notes that this general caution is not intended to limit Finance Board director access to information which is necessary to fulfil the Finance Board duties and responsibilities.

Section 4 restates the rules on acceptance of gifts. These standards really do not break any new ground, but they reiterate the standards already set forth in the executive branch standards of conduct, the board's travel policy and the official reception and representation policy.

Subsection (a) notes that Home Loan Banks and the Office of Finance because they are prohibited sources, because they are entities regulated by the Finance Board are prohibited sources. This triggers the executive branch wide standards of conduct which allow for the acceptance of a gift from a prohibited

source if its value is \$20 or less with a total of \$50 from one particular source within a year.

Subsection (c) explains that payment or reimbursement of meals and other expenses incurred in connection with a meeting must be governed by the Finance Board's travel policy and procedures, and the Finance Board's official reception and representation policy.

So thus for official travel, reimbursement for meals and related travel expenses is subject to the government-wide per diem rules.

Subsection (d) encourages Finance Board directors and staff to consult with the Office of General Counsel before accepting any gift from a regulated entity or any director, officer or employer of such entity, and that concludes my remarks, and I'd be happy to answer any questions that the board may have.

CHAIRMAN KORSMO: So it's always Arnie's fault is what you're telling us?

MR. WALDEN: Well, he'll be responsible for the yes answers and the no answers.

CHAIRMAN KORSMO: Thank you, Greg. Are there any questions from any members of the board for Mr. Walden? I should note for those in the audience, we did have a briefing on the standards of conduct with Mr. Walden earlier in anticipation of our meeting in August and there were extensive questions at that time, so it may be likely that the questions at this point are limited, but if there are any other questions for Greg.

John?

DIRECTOR WEICHER: I don't have a question, Mr. Chairman, but I just want to express my thanks to you and to you, Mr. Chairman, and to Greg for working with our General Counsel and our Office of Government Ethics.

I know that my position on the board has dimensions that are unique to it, and as with the position of any designee from HUD, and I'm very grateful to getting that sorted out and getting that sorted out expeditiously.

I think this is very appropriate way to proceed and more to the point, my General Counsel in

my Office of Government Ethics thinks this is an appropriate way to proceed, and I'm very pleased to see these standards going into effect.

As some of us know, our predecessor board was often criticized for--

DIRECTOR MENDELOWITZ: The Home Loan Bank Board?

DIRECTOR WEICHER: Precise. Yes, thank you, Allan. The board which preceded the Federal Housing Finance Board was often criticized for precisely what is being addressed here, and especially what's being addressed in the gift and travel policy area and members of the board were frequently the guests of individual regulated entities at various events. That was not conducive to the effective management of the agency, and I think this is highly appropriate and extremely important. I'd be very glad to be able to support these recommendations.

CHAIRMAN KORSMO: Any other questions of Greg? Hearing none, as Mr. Walden notes, he did meet with my fellow directors, and I want to thank my

colleagues for their thoughts and input on the final product. I believe they improved the proposed standard of conduct significantly.

Do we have a motion to adopt the resolution implementing the proposed standards of conduct?

DIRECTOR WEICHER: So moved.

[Motion made.]

CHAIRMAN KORSMO: Dr. Weicher has moved adoption. Is there any discussion of the motion? Is there any discussion of the motion? Mr. Leichter.

DIRECTOR LEICHTER: Yeah. I just want to say I think it's helpful to have this code of conduct, and I think it sets reasonable guidelines for the board of directors of the Finance Board in its dealings with Home Loan Banks in attending meetings that the Home Loan Banks may be having.

When I came on the board approximately two years ago and there was a the practice of board members to attend meetings of the board of directors of Home Loan Banks, and at that time, we followed the practice of not attending part of the meetings of the board of directors, but there really were no clear

guidelines by what part to attend, what part not to attend and so on.

So I think we've come to a reasonable resolution here by saying that when members of this board attend board meetings, we will not attend any of the business part of the Home Loan Bank Board of Directors meetings. I know that I found it helpful to be in communication with members of the board of Home Loan Banks, and I think they found it useful to have access to me and to other directors because, of course, we're not only safety and soundness regulator, we're also mission regulators.

I think that we can carry out our supervisory and our regulatory function without attending meetings of the board of directors, but I just want to make it clear because I know the discussion that we've had among us that the purpose of this code of conduct is not in any way to limit access by members of the board of directors of Home Loan Banks to members of the board of directors of the Finance Board. And I think that should be very clear and members of the board and staff of the Home

Loan Bank should know that they will continue to have access to members of this board as appropriate and as needed for carrying out the business of the Home Loan Banks and the purpose of the system.

So I'm very happy to have these rules and I want to thank you, Greg Walden, for the help and the guidance that you have given us.

MR. WALDEN: You're welcome.

CHAIRMAN KORSMO: Is there any other discussion. Dr. Mendelowitz?

DIRECTOR MENDELOWITZ: Yeah, Mr. Chairman, I just want to make sure that I understand the intent of a couple of aspects of this standard as well as I have a more general issue I wanted to raise. The first is that it's my understanding that from our discussions that any time there's a reference in the standard of conduct that refers to a member of the board of the directors of the Finance Board, that is read as to cover the personal staff of the directors as well?

CHAIRMAN KORSMO: Yes.

DIRECTOR MENDELOWITZ: Okay. Secondly, for example, just to give an example of deliberations of the board, over the past year, we spent a lot of time and effort reviewing and approving the capital plans of the individual banks. And in the course of that process, members of the board of directors at the Finance Board would read draft plans, they would have a reaction, they would provide feedback as to what things they, for example, had problems with in those plans, and there would be nothing, of course, in the standard that would interfere with that kind of communication?

CHAIRMAN KORSMO: Absolutely not.

DIRECTOR MENDELOWITZ: I appreciate that clarification. I do have one general issue which goes a little bit beyond the scope of the standard of conduct for discussion, so I hope that you won't think I'm out of order, but there is a concern that I have in the System over the quality of corporate governance in the system.

In my time at the Finance Board, I've made some effort to try to get a understanding of the

quality of corporate governance in the system, and the conclusion that I reached on the limited information that I've developed personally is that the quality of corporate governance is very uneven. And given the absolutely essential role of corporate governance in assuring a well-managed business and given the crises we've had in the American corporate world over failings of corporate governance, I think it's incumbent upon us to raise the priority given to examinations in the System with respect to corporate governance.

Probably the area of bank operations that have received the least examination if any has been corporate governance. And I would like to propose to you that we, along with this resolution as we approve it, because I know we all support it and think it's a good idea, that we also as a board of directors direct the examination staff to begin within the next three months a System-wide audit and examination of corporate governance with the objective of identifying best practices that should be applied across the system to ensure effective corporate

governance as well as weaknesses that need to be corrected.

And I would feel a higher level of comfort knowing that we are undertaking that deliberate and appropriate examination of corporate governance.

CHAIRMAN KORSMO: Dr. Mendelowitz, I appreciate your comments and your concern in this regard. As you know, we had this discussion among and between ourselves before, and we agree. I don't know that it's precisely on point with this particular agenda item.

DIRECTOR MENDELOWITZ: Right, yeah.

CHAIRMAN KORSMO: But I share your perspective on this, and I think it is appropriate for us and I can made that commitment that we will focus the supervisory staff in this direction.

As you know, it is on our agenda in the broadest sense of the term--

DIRECTOR MENDELOWITZ: Right.

CHAIRMAN KORSMO: --not specific to meeting agendas. It is on our agenda to take a close hard look at board governance. It is an issue that has

been raised even prior to our participation here as members of the Finance Board and it certainly is an appropriate focus for us, and one that I think was part the mandate that Dr. Cross received when he was named the director of our Office of Supervision. So I appreciate your comments in that regard.

Is there any other discussion on the motion? Director O'Neill.

DIRECTOR O'NEILL: Just in furtherance of discussion that just was had, we always have a meeting of all of the boards of directors of the 12 banks. I think it's scheduled for November. Maybe that is the time that we can get into this issue of governance?

CHAIRMAN KORSMO: Well, I think we want to be well down the road before we get to that point. In fact, I'd like to have some preliminary--I'd like part of the agenda that November meeting to be some of the concerns that we've already identified and raised them with those people is exactly the reason why we want them all to come to town.

I think it has to be more than a social gathering, more than an opportunity for us all to meet them and exchange pleasantries. It has to be an opportunity for education and for commitment and dedication and a recognition of the concerns that we have as the members of the Finance Board with the job they have and responsibilities they have as members of the boards of directors of the individual banks.

So I think we want to be down the road on this prior to the November meeting. Yes, sir?

DIRECTOR MENDELOWITZ: Mr. Chairman, I highly endorse the alacrity with which you recognize the importance of addressing this, and correlated to this is that in the literature on co-ops, there is a recognition that there are structural defects in corporate governance associated with co-ops that don't exist with respect to publicly traded corporations, and as part of this effort, I think the folks who do generally the policy analysis, I would also like to ensure that they look into identifying potential problems in corporate governance that are unique to the corporate structure that may require us

to look into regulatory action to correct those sort of defects associated with corporate governance that are structural to a co-operative system.

CHAIRMAN KORSMO: I appreciate your calling that to our attention. I think it's appropriate and certainly provides us some focus for moving ahead.

However, now let's deal with the issue at hand. Is there any other discussion on the motion? Any other discussion of the motion? Seeing none, the question is on the motion to implement the standards of conduct for Federal Housing Finance Board directors, officers and employees.

The Secretary will please call the role on the question.

MS. BAKER: On the motion before the board, Director Leichter, how do you vote?

DIRECTOR LEICHTER: Aye.

MS. BAKER: Director O'Neill?

DIRECTOR O'NEILL: Aye.

MS. BAKER: Director Mendelowitz?

DIRECTOR MENDELOWITZ: Aye.

MS. BAKER: Director Weicher?

DIRECTOR WEICHER: Aye.

MS. BAKER: Chairman Korsmo?

CHAIRMAN KORSMO: Aye. Excuse me. Motion is carried. I don't know whether I'm in the draft here today, but the frogs are moving into my throat. Anyway, the motion is carried. The standards of conduct are approved and adopted. Thank you to all my colleagues.

Thank you again, everyone, who had a role in developing these standards of conduct. Greg Walden, we very much appreciate your input to this process. It has been invaluable. John Mantini and the others in the General Counsel's Office who contributed and, of course, my board colleagues.

With adoption of these standards of conduct and our institutional and individual commitment to following them, we ensure our integrity, fairness and impartiality. We also make certain to avoid inappropriate interference in the internal operation of the Federal Home Loan Banks and perhaps as important, we avoid the appearance of impropriety.

These are standards we are obliged to meet as regulators, and just as importantly as stewards of the public interest. Thank you all again on this item and thank you, Greg, I appreciate your being with us today.

MR. WALDEN: You're welcome.

CHAIRMAN KORSMO: The next item on our agenda--after I've already confessed to losing my voice, he tells me to speak up. It still says Greg Walden, but I recognize it is indeed Charles McLean, so we now turn to final action on a rule that holds great promise for helping more American families become home owners by increasing the funds for home ownership set-asides in the Affordable Housing Program.

The Finance Board unanimously approved the proposed rule on June 12. The 60-day comment period ended on August 19. We received seven comments; is that right, Charles?

MR. McLEAN: Seven, yes.

CHAIRMAN KORSMO: Seven comments on the two issues involved in the rule, all in support of the

proposal. Currently Finance Board regulations authorize the Federal Home Loan Banks each year to allocate the greater of \$3 million or 25 percent of their AHP contribution for home ownership set-aside programs, and I understand at least a couple of the banks were knocking up against that ceiling, if I'm not mistaken.

The rule we vote on today will allow each bank to set aside an additional amount of up to the greater of \$1.5 million or ten percent of their annual AHP amount specifically for first-time home buyers.

This increased funding authority will enable the banks to provide up to an additional \$24 million this year. The final rule will also increase the maximum subsidy limit per household to \$15,000 for home ownership set-aside programs in general.

With grants to families ranging from \$5,000 to \$15,000, this initiative can provide assistance for somewhere between an additional 1,600 to 4,800 additional households.

I was interested to read the article in last Saturday's American Banker about the Federal Home Loan Bank of Atlanta encouraging its member financial institutions to use the new market's tax credit in tandem with its community development programs. The goal is to help development in poor neighborhoods by drawing together financial support from several sources. The same philosophy has long guided the Affordable Housing Program.

And today's rule is an excellent example of it. President Bush, Secretary Martinez and we at the Finance Board all share a keen awareness that we can do more to help first-time home buyers, especially among minorities and immigrants who face additional obstacles to home ownership.

With this new authority, the Federal Home Loan Banks can work in tandem with HUD's programs to get more done so more people can afford to buy a home.

The initiatives include the Self-Help Home Ownership Opportunity Program, Section 8 Home

Ownership Program vouchers, and the Home American Dream Downpayment Fund.

In addition, Federal Home Loan Banks can use or all part of their set-aside funds to supplement the savings of households that participate in the Family Self-Sufficiency and Individual Development Account Savings Programs.

Those programs reflect a solid understanding of how housing really works. A study last year by the Federal Reserve Bank of Minneapolis reported that cash assistance to the home buyer does more than any other option in helping a renter become a first-time home owner. The report said that a \$5,000 cash grant for downpayment assistance increased the percentage of minority renters who could afford a home by as much as 13 percent while a \$10,000 grant had nearly twice the effect.

It's appropriate at this point, I believe, to recall Secretary Martinez' comments last spring when he spoke to our public interest directors conference, when he said, "The fact that we have a home ownership rate today of nearly 68 percent speaks

to the success of the Federal Home Loan Banks. However, minorities are not equally sharing in the housing boom. Roughly, 47 percent of hispanics and 48 percent of African Americans were home owners in 2000, well below the U.S. average."

"We obviously have a long way to go, but because the president and I"--this is Secretary Martinez speaking--"believe so firmly in the transforming power of home ownership, we are committed to closing the gap." Yes, we do have a long ways to go, but with today's approval of the rule to help low and moderate income families buy their own homes, the Finance Board is also taking action toward closing that gap.

I hope I haven't stolen all of your speech, Charles, but with that, let me call on Charles and Sharon and Melissa to present this board item.

MR. McLEAN: Thank you, Mr. Chairman. Good morning, directors. The staff is before you today to recommend the adoption of a final rule amending the regulation governing the Affordable Housing Program, the AHP.

Consistent with the proposed rule, the final rule would amend the AHP regulation to authorize the bank after consultation with its advisory council to set aside annually up to the greater of \$1.5 million or ten percent of its annual required AHP contribution to assist low or moderate income first-time home buyers.

It would also authorize the bank to set aside the greater of \$1.5 million or ten percent of its annual required AHP contribution for the subsequent year to the current year's first-time home buyer set-aside program in cases where the amount of funds applied for by members in a given year under the first-time home buyer set-aside program exceeds the amount available for that year.

The increased discretionary funding authority would supplement the Bank's current discretionary authority to fund home ownership set aside programs subject to the existing \$3 million or 25 percent allocation cap.

The determination on whether to use the increased funding authority would be left to the

discretion of each bank after consultation with its advisory council. If used, such increased funding would have to be targeted to first-time home buyers subject to any additional eligibility criteria adopted by the bank for its program.

This targeting to first-time home buyers makes this set-aside more focused than other set-aside funding which may address broader home ownership and rehabilitation needs. A bank may also supplement the first-time home buyer set-aside by targeting some or all of its current set-aside authority under the existing \$3 million or 25 percent allocation cap to first-time home buyers.

Consistent with the current AHP regulation, the final rule would not define the term "first-time home buyer," leaving this to the discretion of each bank as set forth in its AHP implementation plan.

In the proposed rule, the Finance Board also requested comment on whether the regulation should be amended to increase the existing \$10,000 maximum subsidy limit per household or whether the bank should be provided the authority to determine

whether to adopt a maximum subsidy limit per household.

Several commenters and a number of banks generally supported increasing the maximum subsidy limit per household. To assist the home ownership set-aside in being an even more effective tool, especially in high cost areas, the final rule would amend the regulation to increase the maximum grant that a bank is authorized to make under the home ownership set-aside programs generally from \$10,000 per household to \$15,000 per household.

Finally, some commenters introduced issues that were beyond the scope of the proposed rule. For example, one commenter suggested that the Finance Board undertake an analysis of the benefits and effectiveness of the homeownership set-aside, in particular, studying the relative impact and effectiveness of funding homeownership projects through the set-aside program in contrast to the competitive program by examining such factors as the incomes of the households served, the characteristics

of participating members, and the impacts on the community stability.

We plan to begin immediately our analysis of those issues and others arising from our recent experience with the AHP program. As appropriate, those issues could be subject to subsequent rulemaking.

At this time, the staff recommends the board adopt the final rule concerning the AHP set-aside allocation and the increase in the maximum subsidy limit per household. That rule is contained in the board book. We would also be pleased to answer any questions you may have.

CHAIRMAN KORSMO: Thank you, Charles. Are there any questions for Charles or Sharon or Melissa? Any questions? I am interested in the suggestion about the study. I don't know why, but for 20 years or so I have been on the Federal Reserve Bank of Minneapolis' mailing list, so I actually got the report.

MR. McLEAN: Yes.

CHAIRMAN KORSMO: A significant--I shouldn't say significant, but probably before anyone else did I had a chance to look at it, and I'd be interested in your perception, Charles. I don't know if you've had a chance to look at that report. Maybe you have. Maybe you haven't. If you have not, I would recommend it to you, because I'd be interested in your perspective given your experience here at the Finance Board and working with Affordable Housing Programs as to the conclusions that the Minneapolis Bank drew in that regard.

MR. McLEAN: I thought it was extremely interesting, and in fact, the section that I saw, the subsection--I didn't read the whole report--which indicated that in contrast to interest rate subsidies, that the downpayment assistance, direct grant assistance in terms of downpayment assistance and closing costs assistance was so much more efficient and effective than the other mechanisms that we had been using overall.

So I don't know whether our study, if we go forward in the study of looking at the competitive

program versus the homeownership set-aside will indicate that as well, but that's certainly a good starting point.

CHAIRMAN KORSMO: Am I right, and maybe you are the one who told me, that a couple of the banks are currently bumping up against the current ceiling, the \$25 million ceiling; is that right, Melissa?

MR. McLEAN: Yes.

MS. ALLEN: Yes.

CHAIRMAN KORSMO: Okay. So this really does have the potential to have an immediate impact on programs?

MR. McLEAN: It does have. I think also as we mentioned, in high cost areas, a number of the banks have suggested that they felt somewhat constricted with the \$10,000 limit in terms of able to serve people of lower income in high cost areas including Boston and San Francisco in particular.

CHAIRMAN KORSMO: Director O'Neill.

DIRECTOR O'NEILL: We have been at what I call polishing the crown jewel of the Federal Home Loan Bank System for a long time now.

We did a big rewrite of the Affordable Housing Program in 1998; is that right?

MR. McLEAN: '97. Effective January 1998.

DIRECTOR O'NEILL: How many times have we come out with modifications since we rewrote it?

MS. LIKE: Probably five or six times.

MR. McLEAN: Five or six times.

DIRECTOR O'NEILL: Well, I think that this, obviously I think that this is very good that we are continuing to do this, so I compliment the staff, and I think that things are getting better all the time with the programs. So I want to thank you for all the work that you have done.

MR. McLEAN: Thank you.

CHAIRMAN KORSMO: Are there any other questions of the staff? If not, I would ask for a motion for final adoption of the proposed rules.

DIRECTOR WEICHER: So moved.

CHAIRMAN KORSMO: The motion by Dr. Weicher. Is there any discussion of the motion? Head scratching?

DIRECTOR MENDELOWITZ: No, I was just going to second it. I forgot we don't do second.

CHAIRMAN KORSMO: We don't do that. Dr. Weicher.

DIRECTOR WEICHER: I just wanted, a comment that I was looking through the briefing book about the activities. The American Dream Downpayment Fund was originally was patterned on a program developed originally at the Federal Home Loan Bank of Dallas. And the president developed it and endorsed it and spoke for it vigorously during the campaign and has spoken for it and pushed for it since then including during his appearances during National Homeownership Month in June, and I think it's very appropriate, and I'm very pleased that we're making it possible for the Home Loan Banks to build on what the Dallas Bank in particular and also the Pittsburgh and New York Banks, from my understanding, have been doing as well to promote homeownership.

There are all sorts of academic studies showing that for most families, the barrier to home ownership is the downpayment and the closing costs,

the up-front costs, not for everybody, but for perhaps two-thirds, that's the problem. And for--

CHAIRMAN KORSMO: I know it is for me.

DIRECTOR WEICHER: Well, you should look for a more affordable home.

[Laughter.]

DIRECTOR WEICHER: May I recommend that you contact your local FHA lender and we'll see what we can do for you, provided you're a satisfactory credit risk.

CHAIRMAN KORSMO: Well, that may be the problem.

DIRECTOR WEICHER: Now I've lost my train of thought.

[Laughter.]

DIRECTOR WEICHER: But the remaining one-third or so have a problem with the mortgage payment. And so no one program is a solution to the problems of all families that are on the margin of becoming homeowners, but certainly downpayment is a bigger hurdle for more families than the monthly payment, and I think the rule and the broad initiative are

very much in line with the appropriate public policy that has been the policy of the federal government, the avowed policy of the federal government since the days of President Franklin Roosevelt.

CHAIRMAN KORSMO: Thank you, Dr. Weicher. Any other discussion of the motion? Hearing none, the Secretary will please call the roll.

MS. BAKER: On the motion before the board, Director Leichter, how do you vote?

DIRECTOR LEICHTER: Yes.

MS. BAKER: Director O'Neill?

DIRECTOR O'NEILL: Aye.

MS. BAKER: Director Mendelowitz?

DIRECTOR MENDELOWITZ: Yes.

MS. BAKER: Director Weicher?

DIRECTOR WEICHER: Aye.

MS. BAKER: Chairman Korsmo?

CHAIRMAN KORSMO: Yes. The motion carries, and the rule is adopted or the regulation is adopted. Thank you very much, Charles, Sharon, and Melissa. We appreciate all your hard work in this area over obviously several months, and I'm glad we could bring

this process to completion today. Thank you very much.

I will ask Judith Hofmann and John Waters to join us at the table. We now come to the--lots of paper today--we now come to the Federal Housing Finance Board's proposed budget for fiscal year 2003. Judith Hofmann, our Director of the Office of Management is here, and I want to express my appreciation to Ms. Hofmann and her staff, John Waters, in particular, for the excellent and voluminous work this document represents.

The proposed budget for fiscal year 2003 is \$27,065,253 for the fiscal year beginning October 1, eight percent below the 2002 budget of \$29,509,767. As the overview document in the board book explains, this \$2.4 million decrease in budgeted spending reflects a concerted drive to eliminate unnecessary expenditures.

At the same time, the budget addresses the Finance Board's renewed focus on its primary responsibility ensuring the safety and soundness of the Federal Home Loan Bank System. And already

today, we've had occasion to discuss the need for enhanced emphasis in that area.

Accordingly, I want to highlight the \$2.8 million increase for the expansion of the Office of Supervision including the addition of 11 new bank examiners, four analysts, a senior risk advisor to the Director of the Office of Supervision, and two associate directors.

We're able to accomplish this significant increase in personnel and administrative support for safety and soundness through the recent reorganization, which allowed the reallocation of resources as well as the savings I mentioned a moment ago.

The major savings are listed as items one through four in the overview: the elimination of the Offices of Communications and the Managing Director; the winding down of several large information projects; a more efficient and sensible, I believe, approach toward building and support services; and finally reduction in vacant positions.

Along with supervision, the other significant increase is the half million dollars related to plans to renovate the agency office building and move staff into temporary quarters during renovation should that come to fruition.

Again, Ms. Hofmann and Mr. Waters here to respond to any questions, so if there are any, I'll open the floor. Judith, do you have anything more you wanted to mention?

MS. HOFMANN: The only thing I would add, Mr. Chairman, actually the increase for supervision is approximately 3.5 million.

CHAIRMAN KORSMO: Pardon me.

MS. HOFMANN: If you add the additional support that goes for the additional positions.

CHAIRMAN KORSMO: Okay. Are there any questions of either Ms. Hofmann or Mr. Waters? Mr. O'Neill?

DIRECTOR O'NEILL: I said this at the briefing, and I figured I should put it on the record, but with the reorganization coming so close to the end of the year, I know that both Judith and

John Waters had to do yeoman's service to reposition a lot of things that the agency needed that were in those two functions that were eliminated. So I want to say how much I appreciate both all of your hard work in that, getting it done and getting it done on time so that we could get this done before the end of the fiscal year. So thank you, both.

MS. HOFMANN: Well, thank you, and as I said at that time, it really was John who had the brunt of all of the additional work that was necessitated by the reorganization.

CHAIRMAN KORSMO: Are there any other questions for the staff? Dr. Weicher.

DIRECTOR WEICHER: I think I know the answer to this, but I want to make sure. With the combination of the Office of Supervision and the Office of Policy Research and Analysis, I don't find in the budget presentation explicit indication of the number of positions that are transferred from Policy Research and Analysis into the Office of Supervision.

My understanding is that all were except for the two that are--sorry--the three that were being eliminated.

MS. HOFMANN: Were vacant. Everyone was just transferred en masse into the new organization.

DIRECTOR WEICHER: Okay. So they all show up in the Office of Supervision as staff?

MS. HOFMANN: Yes.

DIRECTOR WEICHER: And of course, as you know better than I do, in the HUD budget when you're terminating something, you still carry it in the budget presentation, because it's in the current year, and you show it as zeros in the out-years, and I don't know that we have ever done that for personnel particularly, but I was looking for some indication of that and didn't see it in there and I wanted to make sure I understood it correctly.

MS. HOFMANN: Everyone was just transferred in, and our budget is a little bit different because being non-appropriated funds, it's a lot simpler, and I guess maybe Mr.--

DIRECTOR WEICHER: Oh, I see.

MS. HOFMANN: It does make a lot of difference in not having to present it to OMB. And one thing that I didn't add, Mr. Chairman, to just put our budget into perspective, 67 percent of the budget is salaries and benefits. And if you add rent, IT and travel to that, it takes the number up to 92 percent. It's a basic S&E annual type of budget. We have no carryover funds or special funds which you're familiar with, the FHA funds, that are multi-year type funds.

DIRECTOR WEICHER: Sure, sure.

CHAIRMAN KORSMO: Are there any other questions for the staff? Dr. Mendelowitz?

DIRECTOR MENDELOWITZ: Yes. There was something about the IG staffing level I didn't understand. On the addition side, in your memo, Judith, you say that the Inspector General is going to get one more TS-11 auditor, and then in the positions eliminated, you say that the Inspector General is losing one TS-11 auditor, so I'm not sure what's going on here.

MS. HOFMANN: Do you want to explain that, John?

MR. WATERS: Yes. We went through and eliminated a number of positions that had been vacant. But we did give the office directors the opportunity to request new positions if they could justify those positions. So essentially the position was eliminated, but the IG had the opportunity to come back and requested that position be reauthorized.

CHAIRMAN KORSMO: Which he did.

MR. WATERS: Which he did. He provided justification.

CHAIRMAN KORSMO: So in the document, then we have a debit and a credit, if you will. We debited out the vacant position and credited in the request for the--

DIRECTOR MENDELOWITZ: A new vacant position.

CHAIRMAN KORSMO: A new and currently vacant position; correct?

DIRECTOR MENDELOWITZ: Okay. I just wanted to make sure I understood it.

CHAIRMAN KORSMO: You're not the only one who had that question. The Inspector General had a little question about that, too, when he saw the budget, and fortunately I could point out to him where it comes out and where it comes back in. So one of the vagaries of the process, I believe.

If there are no other questions, I would ask for a motion to adopt the budget for fiscal year 2003. Is there a motion to adopt the budget?

DIRECTOR O'NEILL: So moved.

[Motion made.]

CHAIRMAN KORSMO: Director O'Neill has moved adoption of the budget. Is there any discussion of the motion? Any discussion of the motion? I have some discussion of the motion if there is no other discussion of the motion.

I think all of my colleagues are aware that Director Leichter and I had a discussion raising some particular points of concern that he had, not so much with the budget per se, but with the process and the

ongoing process of acknowledging or, excuse me, of keeping track of where we are with the budget, and I will have to confess that this has been an interesting experience for me since I've been chairman.

This is the first time I've been affiliated with any organization where those responsible for its oversight didn't receive regular reports of where we are in the budget process going through the year, and so I asked that question in preparation of the budget, if those reports are indeed being prepared?

And Mr. Waters told me, yes, indeed, we prepare a--I prepare a budget status report every month. Well, I was not getting it under the previous management information structure, and my assumption is that if I wasn't getting it, you all probably weren't getting it either.

I think now that we have reorganized the management structure here, and just, if you will, have flattened it to one of the things I've suggested is that it would certainly be helpful for my fellow directors and me if we received a monthly report of

where we were on a line item basis in the budget process, and so the commitment that I've received from the director of our Office of Management and from our budget person is that we will be receiving those reports.

One of the improvements, I think, may come out of this, and please correct me if I'm misstating this, Judith, as to how it will occur. One of the questions I asked is what kind of time frame can we expect in terms of how long do we need following the close, in other words, at the end of the month, how long does it take to get the information accumulated and inputted so that we can produce a meaningful report that reflects where we are in the budget?

And right now, apparently, today is the 12th of September, and I know that the report for the August numbers are indeed available, and if I understand what you've told me, once we convert to the People Soft process on October 1, we may actually be able to--John's panicking that you've committed him to deadlines he doesn't necessarily want to have to meet.

But we may indeed even be able to move that process forward. One thing I would like to shoot for as a goal is we've kind of fallen away from our housekeeping meeting process for a lot of reasons. One we've had a busy summer and vacation times have interceded, but I think we want to establish a regular pattern of housekeeping meetings again as we started to do last spring, and one of the impetuses for doing so, and obviously one of the items that would be appropriate for us to consider in every case in that regard, would be where we are indeed in the budget process and what changes have occurred or are anticipated that may have to take place?

My original thought was given how my colleagues have been interested in receiving information prior to us having our formal board meeting, to the extent possible, and we're always under a time constraint, it may not be possible, but I would prefer to have that housekeeping meeting in advance of our regular board meetings. It may not be possible is what I'm suggesting here, at least at this point, to be able to do that significantly ahead

of our regularly scheduled second Wednesday of every month meeting.

It may not give John enough time to close out the books for the preceding month to prepare the report that I would like to be able to share with my board colleagues. So at least in the interim, I think I'm going to suggest that if it's possible and it works out, we will try to schedule these regular housekeeping meetings, maybe for the week after our regularly scheduled board meeting, at least until such time as we think that we can take a look to see (1) whether it works out; whether it makes the discussion meaningful, particularly the budget discussion, and if it does not--and if it fits everyone's schedule frankly.

If it does not, we will try to come up with something else, but at least in the meantime, what I wanted to mention in this context is that I think this process may go a long way to meeting some of Director Leichter's concerns about being kept up to date with where we are in the fiscal process.

One of the other items I think you mentioned was us engaging in any contract over a particular sum. I think there are some limitations in our policy now about that. I certainly have no objection to an enhanced communication between the management and the chairman and the other members of the board in that regard, and I'm more than happy to commit to doing that. And as I am with the other items that Director Leichter raised with me.

The only caveat I would give in that regard is obviously I have to be concerned about any commitment I make that may at some point jeopardize the efficient and effective operation of the staff here, and I certainly think everyone understands that that has to be a concern for me, and also to the extent that it's relevant and I can't come up with off the top of my head the situation where it may be, but where there is some confidentiality issue at stake.

But it is my commitment, as you've heard me make in a number of other contexts, to do everything I can to improve to the extent I can the level of

communication that exists between the chairman who is charged with responsibility for managing the day-to-day operations of the agency, and charged with dealing with personnel and budgetary issues.

To the extent that I can improve the level of communication that we have on those issues, I'm here today to commit to doing so. I think perhaps this reinvigoration of our housekeeping process and the opportunity to have a monthly report available on where we stand on the budget process should be helpful in that regard.

Dr. Leichter.

DIRECTOR LEICHTER: Yes. Mr. Chairman, first of all, I want to say I'm really pleased that we're doing the budget at a formal meeting of the board of directors. The two previous budgets that I was asked to act on as a director were done by notational votes, as if the budget was some either insignificant document or something that we wanted to do in the dark of night.

I'm glad you brought it out into the open and I think it's part of what I really find a

commendable direction of having more orderly process, not only for the budget, but some of the other things we do and certainly having these housekeeping meetings is very helpful, and I'm also pleased that you and I had discussion and that you responded favorably to some concerns that I had and you've mentioned one of them, and I just want to clarify the other two.

The one that I think is very important, because I think all of us want this to be a realistic viable budget, and I was surprised, and I probably should have known this before, but that the chairman under existing procedures had the authority unilaterally to transfer appropriations from one office to another without the involvement of members of the board of directors. And I thought--

CHAIRMAN KORSMO: You shouldn't have told me about that, because I wasn't aware.

[Laughter.]

DIRECTOR LEICHTER: Well, I wasn't either, and I don't know how often it's occurred in the past, but clearly if there is going to be a realistic

budget, not a sham, it certainly does not make sense for us to pass a budget and come October 2 have somebody with the authority to completely change the budget around without notification to other members of the board of directors.

So one of the things that you and I discussed, and you were very responsive on, and I just want to clarify for the record, that before any transfer of any funds are made from office to office, if that should become necessary, that 72 hours advance notice will be given to other members of the board of directors so the directors would have a chance to give you their input on this.

Now, this is as well as the other condition you previously mentioned about contracting, obviously if there is an emergency, I think we all understand that a different time table will have to be met, but I think we're all flexible, realistic people and if such an emergency comes about, I don't think we would have any trouble, but I think in most instances there should be no difficulty in getting members of the board of directors a 72-hour notice.

The other condition that I thought was very important, since we've set up a budget which provides for salaries and so on, and particularly in view of the concern that's been expressed by some members up on the Hill about the compensation level, at the board, that if any new employee is hired at a salary in excess of \$130,000, or if the salary of an existing employee whose salary may be in excess of \$130,000 and is raised to some additional amount, that again 72 hour notice will be given to the other members of the board, so that again members of the board may fulfill their proper function of deliberating and that collectively we decide on these issues.

So I believe that we have an understanding on that, and I just want to see that we have it clear for the record.

CHAIRMAN KORSMO: Let me respond to a couple of things, touch a couple of issues you've raised, Franz, and thank you for your comments. I appreciate your appreciation of the fact that we're

actually adopting a budget in open meeting, which it actually goes back farther than you suggest.

I looked, and this will be the first time since at least 1996 that the board has actually adopted a budget in open meeting. In fact, in 1997, the board didn't adopt a budget at all. The chairman announced the budget by executive fiat under his reading of the delegation of authority to him. In that capacity, he announced what the budget is, and that was the end of it.

Tim, you were probably here then and can recall that process, and I certainly have no objection to making sure that the items particularly that you are concerned about, assuring you and my colleagues that there will be some increased communication in that regard. I think we may have, if this process of having a monthly review of the budget comes into play, all of those issues won't arise.

In reaction to some of the things you've talked about, however, I did make some inquiry, and so I want a little bit of clarification on some of

the things that you would like to see us do by way of process. So one is that my understanding, after having made inquiry in this regard, I told you that I wasn't aware that I had authority to move items from line item to line item, and apparently that within office budgets that occurs on a fairly regular basis, and is practically a routine procedure that John engages in.

And Judith, you may talk about that briefly. So what I'm suggesting is I'm hoping what you're talking about is if we talk about moving significant amounts of funds, for example, from the Office of Management to the Office of Supervision.

DIRECTOR LEICHTER: Precisely.

CHAIRMAN KORSMO: Or from the General Counsel's Office to the Office of Management. That's what you're talking about. You're not talking about line items that are transferred within office budgets because--

DIRECTOR LEICHTER: No.

DIRECTOR MENDELOWITZ: Like from your travel budget to my travel budget.

CHAIRMAN KORSMO: Yeah, exactly. Well, that may be one we'll have to discuss. I want 24 hour notice of that one, but you may want to mention some of the practice and what it has been and what it needs to be.

MS. HOFMANN: Well, yes, Mr. Chairman. I mean that does occur, and it's the same with the new budgets. For instance, for the board members, they've got a total, and they can allocate the funds. I mean they've been allocated for budget presentation purposes, but each board member can decide where he wants to spend his money and how he wants to spend it, and the same process occurs in each of the individual offices.

By and large, there is not much deviation from the line items as they're set up in the budget, and I don't believe, since I've been here, we have reprogrammed or, you know, what we would refer to it in an appropriated agency as reprogram money from one office to another office in the last six months. Has that occurred, John?

MR. WATERS: To the extent that we have transferred some personnel costs, where positions have been delayed, and we've had some unusual or unanticipated events occurring this year, a number of studies, we have separation payments that we now have to fund. There is a mechanism to transfer funds, to carry those initially unexpected events that have happened this year, primarily that has involved salary and benefit budget money that's freed up because positions were not hired when they were anticipated to be hired.

CHAIRMAN KORSMO: The other item I wanted to address was the concern about particular hiring practice and levels of salaries, and I would suggest this might be an issue that we as a board might want to discuss in a housekeeping session, not because I'm backing off of my commitment to be more open about this process, but there are two things that I think we need to discuss, and this may not be the appropriate place to discuss it.

One is the current practice in hiring. With the exception of the top three career positions at

this point, the General Counsel, the Director of the Office of Management and the Director of Supervision, those are the only ones I anticipate me being involved in at any point, and given the fact we have new people in those positions, I don't anticipate that that will change any time soon.

My own looking over what the budget anticipates in terms of hiring, I can think there may be only two, the associate directors' positions in the Office of Supervision, that may involve exceeding the limit that you suggested in this regard. And frankly, if I didn't have confidence in Dr. Cross' ability to make the decision in terms of hiring in those positions, I wouldn't have hired him.

So I don't intend to interfere in that process, and frankly don't feel qualified to make the decisions in hiring for those positions, and so with that by way of caveat again, we may want to revisit your concern in that area in a different session.

The other concern I have about the particular limitation in terms of dollars that you portray is it's a significant percentage of the

employment base here including I would remind you your former personal assistant, and we are coming to the period now where everyone's salary is under review for the regular end-of-the-year merit and bonus process, and I don't know necessarily, again, that it's appropriate for me or the other members of the board to interfere in that process except in a very general sense.

So, as I say, this may be, I'm certainly committed and more than willing to make the commitment that we will enhance the level of communication on these kinds of issues that are of concern to you, but I think we may want to revisit some of those limitations if you don't mind in another session so we're all aware of what the practice is here, and more to the point I see the General Counsel having some concerns about how we address personnel issues that may be require some additional discussion that we can certainly enter into in a housekeeping session.

Is there any other discussion of the motion to approve the budget? John Weicher.

DIRECTOR WEICHER: I just want to comment a bit on the concern on the question of transferring funds between activities. As an executive branch agency, we are limited in--we, HUD, are limited to the extent that we can transfer funds between accounts and have to obtain reprogramming from Congress or reallocation from OMB. Within individual accounts, there is flexibility, and my experience in the department it's always true that what you start out planning to do at the beginning of the year is not exactly what you wind up doing at the end of the year, and you have an agenda, you expect to plan, and you expect to adhere to it, but the nature of what we do is that things change, and you wind up doing other things.

Certainly, in our area of security activities, while not in FHA, but in the department, security activities wound up taking a significantly larger share of our budget than we anticipated they would at the beginning of the fiscal year.

So I think that I don't myself as a board member want to be involved in details of transfers of

funds between, certainly within offices and not really between offices, unless they're significant and raise policy issues. I think it's useful to be informed, but I can imagine that the activities of this year, despite the collective wisdom and experience of members of the board will not match dollar for dollar or close to dollar for dollar what we now think we are going to do.

CHAIRMAN KORSMO: Thank you, John. I appreciate that comment. If I hear you, Franz, your concern was not so much the line item transfers as if there was a major transfer from department to department, and my response to that is that I anticipate that if we're looking at the budget process on a monthly basis, as I'm saying that we will, that that concern could be alleviated. Yes?

DIRECTOR LEICHTER: I just want to, both responding to your comments and to Dr. Weicher's comment, I'm not suggesting that we interfere or what a normal process is. There is no question that every budget is going to have some modification. I'm just suggesting that notice be given to the members of the

board of directors, and I'm not sure that just having these monthly meetings, helpful as they are, in review of the budget will satisfy that if we come to a meeting and somebody says, oh, I want to show you the last month that we transferred monies from this office to another office.

I think it's important that before that transfer is made that the notification will be given. My understanding of our discussion and your comments you made now are that you will give notice to the other members of the board of directors before there is a transfer from office to office, again with a proviso that if there's an emergency, we obviously would be flexible as far as that notice is concerned.

But that's my understanding, and let me just clarify that, and then I do want to make a comment on the issue of salaries.

CHAIRMAN KORSMO: Go.

DIRECTOR LEICHTER: Okay. But is my understanding correct, that before there will be transfer from office to office, that notification

will be given to the other members of the board of directors?

CHAIRMAN KORSMO: You're talking about some significant restructuring of the office? Obviously, you'll be aware of it, yes.

DIRECTOR LEICHTER: Well, the same thing. I'm asking--

CHAIRMAN KORSMO: Franz, let me ask you a more pointed question. I don't want to get bogged down on this frankly.

DIRECTOR LEICHTER: Yes.

CHAIRMAN KORSMO: It's probably a discussion we can have in a different context.

DIRECTOR LEICHTER: Yeah.

CHAIRMAN KORSMO: But if what you're trying to do is undercut the current delegation of authority that exists between the board and the chairman of this board, let's do it in that way. Why don't you suggest, bring a proposal to this board that suggests that a redelegation of authority and let the board consider it.

To the extent that this is an effort that's directed at undercutting that delegation, don't look for me to make any concessions in this regard. To the extent that you're looking for me to commit to some enhanced communication between the chairman and the members of the board here, I've made that commitment.

DIRECTOR LEICHTER: John, Mr. Chairman, I don't know why it's so difficult to say that, yes, I will give notice. We're not dealing with the delegation. You and I have discussed the delegation. In fact, I discussed the delegation before you became chairman.

CHAIRMAN KORSMO: Correct.

DIRECTOR LEICHTER: I happen to have certain views on the delegation, and I think you're absolutely right in saying that it's a matter that ought to be brought before the board of directors. But that's not what we're doing now.

We're adopting a budget. I want to know it's an honest budget, it's a realistic budget, and that it provides actual guidance, and I just want to

be certain that there's not going to be significant changes from office to office without the members of the board of directors who are adopting the budget having notice.

CHAIRMAN KORSMO: I cannot anticipate a situation in which that would occur.

DIRECTOR LEICHTER: Okay. But I don't know why it's so hard to say yes, I'll give you notice before I do it. It's not a matter that afterwards, and Mr. Chairman, to be--let's deal with specific situations.

CHAIRMAN KORSMO: All right.

DIRECTOR LEICHTER: We've had a major restructuring which was not done by the board of directors. I think it should have been done by the board of directors. I happen to--and I was going to make some comments about that, and I will before I vote on the budget.

But the point is it's not sufficient to tell us afterwards. It's something that the members of the board of directors who are adopting this budget in good faith with the intention that this

budget is going to be adhered to, but knowing that changes may have to be made, but before these changes are made, that we're given notification if that's--

CHAIRMAN KORSMO: I understand your concern, Director Leichter. I think I've been quite specific in indicating to you my intention. To the extent that I believe such consultations do not jeopardize the effective management and operation of the Federal Housing Finance Board and in the instances where I think this is relevant, to the extent that I don't believe it jeopardizes needed confidentiality, I have every intention of making those communications with you.

Having said that, let me remind you that for the past nine years, under a delegation of authority that was adopted November 17 of 1993 during an administration that was not of my party, a delegation was made to the chairman of this institution, this agency, that makes, that requires the chair to, and I quote, "to appoint, remove, promote, set compensation for, direct, evaluate and pay Finance Board personnel."

That is the practice here, and I have indicated to you that perhaps more than any prior chairman, it is my intention to share information in that regard, and to make sure that to the extent it's consistent with what my other responsibilities are, that I intend to enhance that level of communication. Beyond that, I don't know what you want me to say.

DIRECTOR LEICHTER: Well, I--

CHAIRMAN KORSMO: I didn't come here to become chairman. I was named chairman to no one's greater surprise than mine, but I take those responsibilities very seriously. These are the responsibilities that have been delegated to me, and I intend to take them.

Again, I don't know how to be more specific on this without, without making a promise that I may put myself in a position that I can't meet consistent with my responsibilities in that regard.

I have indicated that we're going to have a monthly meeting, that we'll review every item in the budget. I've also indicated I cannot anticipate a situation under which there's going to be some major

realignment of the budget line items from the Office of General Counsel to the Office of Management or from the Office of Management to the Office of Supervision.

But I'm more than happy to assure you that if that situation does arise, you will be made aware of it, presumably in advance. Is that what you're asking? I'm more than happy to make that commitment.

DIRECTOR LEICHTER: Okay. Mr. Chairman, you know, I don't think we're dealing here with delegation. As I said before, I will accept your statement that insofar as you will give notice. I don't know why it's so hard to say, yes, I'll give you 72 hours notice.

CHAIRMAN KORSMO: I'll tell you why.

DIRECTOR LEICHTER: Yes.

CHAIRMAN KORSMO: Because I'm not sure I understand with any particular degree of specificity as to exactly what you're looking for, and so what I'm concerned about, based on our prior relationship, is that 73 hours after I have made some decision--

DIRECTOR LEICHTER: Yeah.

CHAIRMAN KORSMO: --I'm going to get a phone call from somebody outside the agency who is concerned about the fact that I didn't provide required notice to my board colleagues on something that I hadn't anticipated would be of interest.

If you want to make a list of items with particular specificity as to what those items are, maybe that's something we can deal with. But until that time, as I mentioned to you, I take my responsibilities as chairman very seriously, and I don't intend to undercut them in advance, in anticipation. Perhaps we've beaten this issue to death and we can move on.

DIRECTOR LEICHTER: Okay. Well, it's a very important issue, and in line with your doing this in an open way I think we ought to have a full discussion.

I just want to say I couldn't be more specific than I've been by saying transfer from office to office, 72 hour notice.

CHAIRMAN KORSMO: Well, in fact, there is--

DIRECTOR LEICHTER: I will accept--I will accept your statement that there will be notice, but let me just say since we've just had a major restructuring that wasn't done by the board, that there wasn't advance notice, which had a real impact on the office, certainly my raising this is not an idle or merely hypothetical issue.

CHAIRMAN KORSMO: And there were real reasons why some of the things I think you would have liked to have had happen did not occur in an open meeting, anymore than I think I would be appropriate at any point for five of us to get together in open meeting to decide who's going to lose his or her job and who is not. There are specific--

DIRECTOR LEICHTER: I didn't ask for an open--

CHAIRMAN KORSMO: There are specific concerns about confidentiality, particularly in personnel issues, that demand that some of those discussions do not take place in a public forum, which is the wisdom of the delegation of authority that some of our predecessors made in providing that

the chairman, and let me say again, is charged with responsibility to appoint, remove, promote, set compensation for, direct, evaluate and pay Finance Board personnel.

There is wisdom in that policy. However, that having been said, if at some point a majority of this board wants to change that policy, I'd be more than happy to have that a topic that we put on this agenda.

DIRECTOR LEICHTER: Okay. Fine. Let me just again clarify. Nobody has said have an open meeting. I said 72 hour notice, but I will let this go, and I will take it that the point has been made, and I will accept your statement that you will provide notice to the members of the board.

I do need to address the issue of compensation. You and I and Dr. Mendelowitz sat in front of the members of the Senate Banking Committee and members of both sides of the aisle, the current chairman, the ranking minority members expressed their--how shall I say it delicately--their skepticism about the supervision that this board had

been given as far as salaries of the staff of the board was concerned as well as salaries of the presidents of the Home Loan Banks, but that's, of course, something that we don't have any supervisory authority over.

But they assumed, and I think rightly so, that all three of us were going to assume responsibility to meeting the concerns that they had. I cannot carry out that responsibility when salaries are determined solely by you without any consultation whatsoever with members of the board of directors. And if that practice continues, if I'm asked by a member of the Senate or anybody else about the salary levels here, I will have to say that that's a function that was taken over by the chairman, and--

CHAIRMAN KORSMO: No, that was a function that was delegated to the chairman.

DIRECTOR LEICHTER: Well, okay.

CHAIRMAN KORSMO: In 1993.

DIRECTOR LEICHTER: All right. But I am now providing specifically without dealing with the delegation, solely on this issue, where I and the

other members of the board of directors have responsibility and will be held accountable that before you hire anybody at a salary--I took 130,000 since that's a salary of members of the board of directors--again, that you give notice--I'm not saying public meeting. I'm not asking for anything special other than notice. So that if there's a problem, then we as members of the board of directors can convey our opinion to you.

You still will have the full authority which you have under this delegation, whether rightly or wrongly or wisely or unwisely, but you have that authority. I'm not challenging that. I'm asking for notification beforehand, so that I may have input. I consider that extremely important, and I was hoping that you and I had an understanding on that. Maybe we did not.

And let me just raise it again to see whether we can get sufficient clarification that will satisfy me.

CHAIRMAN KORSMO: I appreciate your concern in that area particularly, and given the fact that,

as you so correctly stated, the three of us sat there together and were challenged in that regard, let me say two things. One, which I think I've already addressed, I don't, I think there may be a valid concern in that area that we should address, but I've already suggested we may want to revisit that in a housekeeping session to talk about the appropriate levels at which that kicks in.

I don't think--let me rephrase that, because it goes to my second point--I think the concern that was expressed on the part of Chairman Sarbanes and Senator Gramm is a valid one. I think we went a long way to addressing some of those concerns in the reorganization.

And I don't want to suggest for one minute that they don't have a valid concern with the salary levels at this agency below those of the top management. But I think top management is probably the better focus for all of us as members of this board. That having been said, the second point I want to make goes to your concern about those who may fall between the gap of top management level and some

other arbitrary number at which the Senate may or may not be concerned.

That was the impetus behind us contracting with the Hay Group to do a thorough and comprehensive compensation study for us. We do not have the results of that study yet. I understand we're getting close; are we not? In fact, I think some of the recommendations are being reviewed by the senior staff at this time; are they not?

I want my colleagues on the board to understand I have not seen even the preliminary results of that study. I don't want to prejudge it. I don't want to be influenced by it until the final report has been prepared and a recommendation has come to us from the staff along those lines.

So, again, I am sensitive to that particular issue. I want you to understand that. I also want everybody on the board to be aware that we are going to be dealing with that issue in the context of the recommendations that we receive from that consultant.

I'm almost reluctant to raise it because I suspect that that was a contract that cost more than \$25,000; wasn't it?

MS. HOFMANN: Yes, it did.

CHAIRMAN KORSMO: And I didn't provide you advanced notice, but I guess I didn't know how much it cost either. I thought it was something that needed to be done, and I didn't pursue the cost involved specifically any further than that.

So, again, in response to your comments, again I'm trying to be sensitive to that. I think it's a question we should revisit, but probably in a different context. Is there any other discussion of the budget? Is there any other discussion of the budget?

DIRECTOR LEICHTER: Yeah.

CHAIRMAN KORSMO: Yes, sir.

DIRECTOR LEICHTER: One further thing, on the salary, I take it then, we will try to deal with that so that members of the board of directors are properly involved in setting compensation levels, and I just want to say this has nothing to do with who is

chosen, but it's a matter of how much that person will be paid.

I ask again that members of the board of directors be allowed to assume the responsibility for which they're going to be held accountable.

Let me just finally say that this budget reflects a restructuring that's already been mentioned that I and other members of the board of directors did not have any part in. I think we should have. Frankly, I might have done the restructuring somewhat differently.

The reason I mention it is because obviously this budget confirms this particular restructuring. I'm glad that we will be hiring more examiners. Other things I might have done differently. I will support this budget because the restructuring has been done. Obviously, people have to be paid, and we have to function. I will also assume that the discussion you and I have had has sufficiently clarified these issues, and while your answers may not have been as specific as I might have wished or as I think they could have been, I think

there seems to be what I hope is a movement towards the involvement of the board of directors in carrying out their proper duties.

And on that basis, I will support this budget. I also want to express my appreciation to Judith, John and Judith, for the clarification that you've made to me for certain items in the budget and for the work that you've done and I don't want to leave this on an acrimonious note. So let me just reaffirm I'm pleased that we've had a chance to discuss this openly, and I think that's all to the good. Thank you.

CHAIRMAN KORSMO: Any other discussion of the budget? Is there any other discussion of the budget proposal? Seeing none, the question before us is on adoption of the budget of the Federal Housing Finance Board for fiscal year 2003.

The Secretary will please call the roll.

MS. BAKER: On the motion before the board, Director Leichter?

DIRECTOR LEICHTER: Yes.

MS. BAKER: Director O'Neill?

DIRECTOR O'NEILL: Aye.

MS. BAKER: Director Mendelowitz?

DIRECTOR MENDELOWITZ: Aye.

MS. BAKER: Director Weicher?

DIRECTOR WEICHER: Aye.

MS. BAKER: Chairman Korsmo?

CHAIRMAN KORSMO: Aye. The motion is adopted, and the budget is adopted. Thank you again, Judith, and particularly you, John. You've done a great job in difficult circumstances, and I appreciate your hard work in this regard. Look forward to continuing to work with you and what I see is a changed process in the sense that we will probably do a closer job of--not probably--we will do a closer job of monitoring the budget's progress over the year than we have done in past.

Again, I think we have changed the precedent here. As I mentioned, this is the first time a budget has even been discussed in open meeting in at least seven or eight years, and there were occasions when the budget was not approved by the board. So I think Franz' concern about where we

should be, I think we're at least making progress, and I hope my colleagues would concede that point at least to that extent. So thank you very much.

The next item on our agenda is appointment of a member to the Board of Directors of the Office of Finance for a term that expires on March 31, 2005. It occurred to me looking at my budget book this morning--well, actually two things occurred to me. One was that there wasn't a resume of the recommended appointee included in there, so I took it upon myself to make copies of the one I had and I'll distribute to my colleagues on the board, although that having been said, I don't think this particular gentleman requires any introduction to members of this board. He's certainly a familiar face.

The second thing that occurred to me, and Arnie, maybe you can help us out on this, are we dealing with two questions today or one? I was confused by what was included in here. My assumption is that Mr. Roy has been serving as the vice chair of the Office of Finance and is it up to us to reappoint him to that position at this point, too? I guess I

was not clear on that point, assuming his appointment is affirmed by this board.

MR. INTRATER: I'll take a look at that, Mr. Chairman, but the basic thrust of this is to have him reappointed to his current position which just expired in March of this year.

CHAIRMAN KORSMO: Well, again, I apologize to my colleagues on the board that I didn't look at this apparently in sufficient detail in advance of this. I had anticipated recommending James D. Roy, the president of the Federal Home Loan Bank of Pittsburgh for reappointment to the board of directors of the Office of Finance for a term that expires on March 31, 2005.

MR. INTRATER: And that is what--

CHAIRMAN KORSMO: When I looked in the budget book, I saw that there is also a copy of a prior resolution that had named him as the vice chairman of the Office of Finance Board of Directors and it looked to me from that that it is our responsibility as a board to make that appointment as well.

I had not anticipated appointing him to that spot today, but I'd be more than happy to do so, if it's in order.

DIRECTOR MENDELOWITZ: Let's wing it.

CHAIRMAN KORSMO: Let's wing it. Dr. Mendelowitz suggests we wing it. That's what I was trying to suggest to Dr. Leichter or Mr. Leichter a little earlier. It's a joke, Franz. I'm sorry.

MR. INTRATER: Under our regulations, which I'm obviously taking a quick look at on this point--

CHAIRMAN KORSMO: Oh. Mr. Casey points out to me that under our regulations--

MR. INTRATER: It's the office--the--

CHAIRMAN KORSMO: The chair shall--well, let's see. The vice chair shall be selected by a majority vote of the members of the Office of Finance Board of Directors.

MR. INTRATER: Of the board of directors, yes.

CHAIRMAN KORSMO: So I'm wondering what this resolution was dated March 23, 1999 whereby the previous--maybe this was under the--this was the

misassumption of responsibility under the delegation of authority.

MR. INTRATER: We've revised the regulations, number one.

CHAIRMAN KORSMO: Pardon me. Thank you. Well, that would explain my confusion, and I apologize for it.

DIRECTOR O'NEILL: Can I move the resolution in question of reappointing Jay Roy to a board position with the Office of Finance?

[Motion made.]

CHAIRMAN KORSMO: You certainly may. It has been moved that--

DIRECTOR MENDELOWITZ: I would like to second it.

CHAIRMAN KORSMO: Yeah, I know that you're always willing to second. It has been moved that this board affirm the appointment of James D. Roy, President of the Federal Home Loan Bank of Pittsburgh to the board of directors of the Office of Finance for a term that expires on March 31, 2005.

Is there any discussion of the motion?

Allan Mendelowitz.

DIRECTOR MENDELOWITZ: I'd just like to say that Mr. Roy has made outstanding contributions in his term of service on the board of directors of the Office of Finance and I heartily endorse reappointing him. I think the Office of Finance and the System will benefit greatly from his continued service.

CHAIRMAN KORSMO: Is there any other discussion of the motion? Any other discussion? Mr. Leichter.

DIRECTOR LEICHTER: I just want to second what Allan Mendelowitz said. I think we're very fortunate to have Jay Roy continuing as a member of the Office of Finance, and I'm very pleased to see this resolution before us and do heartily support it.

CHAIRMAN KORSMO: Is there any discussion of the motion? Seeing/hearing none, the motion is on the appointment of James D. (Jay) Roy. The Secretary will please call the roll on the motion.

MS. BAKER: On the motion before the board, Director Leichter, how do you vote?

DIRECTOR LEICHTER: Yes.

MS. BAKER: Director O'Neill?

DIRECTOR O'NEILL: Aye.

MS. BAKER: Director Mendelowitz?

DIRECTOR MENDELOWITZ: Aye.

MS. BAKER: Director Weicher?

DIRECTOR WEICHER: Aye.

MS. BAKER: Chairman Korsmo?

CHAIRMAN KORSMO: Aye. The motion is carried and Mr. Roy is reappointed as a member of the board of the Office of Finance. I too obviously share the view expressed by my colleagues. I think Mr. Roy has been a great member of the board. He has contributed in many ways, some of which we will hear about shortly, and so congratulations. We appreciate your willingness to serve in this capacity particularly as we anticipate a new chair being appointed.

I think it was appropriate that we have the continuity on the board that Mr. Roy's reappointment will provide. With that, that completes the agenda

for our regular board meeting. And I will adjourn the meeting of the Federal Housing Finance Board.

As everyone is aware, we have provided notice of a public hearing for today immediately following our board of directors meeting. If it is okay with my colleagues, I would suggest we take a ten minute recess and reconvene at five minutes past noon, at which point we will address the issues of the public hearing. Thank you. Let's be back in 15 minutes.

[Whereupon, at 11:50 a.m., the open meeting of the Federal Housing Finance Board was adjourned.]