FEDERAL HOUSING FINANCE BOARD

BOARD OF DIRECTORS MEETING DIRECTORS

OPEN SESSION

Wednesday, April 12, 2006

10:00 a.m.

Federal Housing Finance Board
1625 I Street, NW
Washington, D.C.

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PRESENT:

Ronald A. Rosenfeld,
Chairman

Alicia R. Castaneda,
Director

Franz Leichter,
Director

Brian Montgomery,
Director

Allan I. Mendelowitz,
Director

Shelia Willis

John P. Kennedy

Stephen M. Cross

Thomas Jennings

Tom Joseph

Jim Shannon

P R O C E E D I N G S

CHAIRMAN ROSENFELD: Good morning, everyone. I call this meeting of the Federal Housing Finance Board to order. Today, we will have an open session followed immediately by a closed session, where the board will receive updates of examinations and supervisory findings. We now need to vote to approve closing the latter portion of this meeting as required by the Sunshine Act of the Finance Board of Regulations.

Since the closed portion of today's meeting will contain sensitive and confidential bank examination information, I would ask for a motion to seal the transcript of this portion of the meeting.

Director Leichter?

DIRECTOR LEICHTER: Mister Chairman, I move to close that portion of this meeting, and further that this board determine that the record and transcript of this closed portion of the meeting be kept confidential.

CHAIRMAN ROSENFELD: Thank you for the motion.

Is there any discussion on the motion?

Seeing none, the Secretary will please call the roll on the motion.

MS. WILLIS: On the item before the Board, Director Leichter, how do you vote?

DIRECTOR LEICHTER: Yes.

MS. WILLIS: Director Castaneda?

DIRECTOR CASTANEDA: Yes.

MS. WILLIS: Director Mendelowitz?

DIRECTOR MENDELOWITZ: Yes.

MS. WILLIS: Director Montgomery?

DIRECTOR MONTGOMERY: Yes.

MS. WILLIS: Chairman Rosenfeld?

CHAIRMAN ROSENFELD: Yes.

The motion is carried and the subsequent portion of the meeting will be closed and the transcript will remain closed and confidential. Thank you.

Let us now turn to the public portion of today's meeting. We meet today to discuss a proposed rule to enhance the corporate governance of each Federal Home Loan Bank by improving the director election process.

The world has changed since the banks were created in 1932. The banks need and deserve a governance structure commensurate with the increased level of sophistication in their operations. As cooperatives, the members own the banks and control the outcome of director elections, but in today's environment, the members need more information about the skills and qualifications most needed by their particular bank as they decide who to nominate and, ultimately, elect to run their institutions.

The proposed changes would enable the banks to provide better information to their members during the director nomination and election process regarding the specific skills needed on the Boards of Directors and the qualifications of the nominees to satisfy those needs.

Mr. Jennings, you'll be making a presentation?

MR. JENNINGS: Yes, sir.

Good morning. Today the staff is recommending that the finance board propose a rule that would allow the Boards of Directors of the Federal Home Loan Banks to take a more active role in the process by which Directors are elected. The purpose of the proposed rule is to have and maintain a Board of Directors that have the skills and experience necessary to establish appropriate policies and to provide the corporate governance that the banks need.

By way of background, almost three years ago, the Finance Board completed a review of the governance practices at the 12 banks. One common theme encountered in this review is that the skills and Directors of the members of the Boards of Directors often don't correlate with the needs of the banks in some critical areas, such as risk management, capital markets, hedging, and so forth.

The staff believes that the Boards of Directors provide better corporate governance when they have the skills and experience in areas that closely match the needs of the organization. This proposed rule is intended to accomplish that purpose. Under the proposed rule, the Boards of Directors of the banks would be allowed to make an annual assessment of the needs and experiences and skills needed by the bank at the Board of Directors level. After that assessment is completed the banks could then inform the voting members of the needs before those members submit nominations to the Boards of Directors for upcoming elective directorships.

This should enable the members who are allowed to submit nominations to better understand the needs of the bank. When the time for voting arrives, the proposed rule would allow each bank to briefly state on the ballots the skills and experience of the candidates. In addition, each bank would be authorized to include with the delivery of the ballots a brief statement of the skills and experiences that the bank identified in its annual assessment.

The staff believes that by providing this information the voting members should be able to make better informed voting decisions. In addition, the election procedures that I just described, the proposed rule would revise the present restrictions on actions during the election process to relate them more closely to the way that the election process will work.

Section 915.9 prohibits bank personnel from referring to Finance Board supported candidates. The staff believes that the existing prohibitions relating to the Finance Board are no longer appropriate because the election process has been devolved from the Finance Board down to the banks and the language that we have here was adopted when the Finance Board took a more active role in the election process.

In conclusion, the staff believes that these changes will improve the election process and that, in turn, will lead to stronger Boards of Directors at the banks. We have a 45 day comment period proposed for these proposed regs. That should give adequate time for the Finance Board to review any comments that are received and consider the final rule before the banks send written notice of the election process to their members.

I will answer any questions that you might have.

DIRECTOR CASTANEDA: Yes. I have some comments, Mister Chairman.

Corporate governance is, of course, an extremely important issue for the banks as well as for any corporation. For a company to succeed in today's environment, directors must be competent and engaged, and Boards of Directors must possess the aggregate skill set to effectively oversee the company business.

For the bank, this has become even more important in light of SEC registration; the requirement of Sarbanes-Oxley and the like. I view today's proposal as a logical outgrowth of the work done by this Board both in the SEC registration, which is where you were referring the review of corporate governance we did a couple of years back.

Of course the banks are cooperatives and the members do and should have the final say in who represents them on the Boards of their Federal Home Loan Banks. But it seems to me that it would be important for members to know what skills and expertise are needed at their banks when they are making their election decisions.

A Board of Directors should routinely conduct such an assessment as a matter of base practice. Of course, such information is of little use to members unless the Board can communicate it to them. Some have said that our existing regulations may prevent the sharing of this type of information with members. If so, that makes little sense as a matter of policy and I hope this proposal will be a step toward improving the situation.

Again, however, we are mindful that the members must retain the ultimate say in the direct election process. We must be careful not to go too far and unintentionally undermine the cooperative concept. I hope and expect that interested parties commenting on the proposal would let us know whether we have struck the right balance here.

And I would like to clarify two points, John, if I may. Under Section 915.9, you list the taxable skills; accounting, risk management, and so on. We are not saying that those are just the skills. I mean, it could be any other skills--

MR. JENNINGS: That is correct. Those are just examples.

DIRECTOR CASTANEDA: I also wanted to clarify that I assume the proposed deletion of references to the Finance Board and its staff in Section 915.9 are not intended to suggest either that the Finance Board intends to get more involved in the election process or that we would look favorably upon anyone that presented that they have reflected use of the Finance Board or its staff. I just don't want people to think that we are trying to signal something else.

MR. JENNINGS: No. You're absolutely correct about that. There is no signal of further involvement in the election process by the Finance Board.

DIRECTOR CASTANEDA: Thank you, Mr. Chairman.

CHAIRMAN ROSENFELD: Any other comments?

Director Mendelowitz.

DIRECTOR MENDELOWITZ: Yes. I need a clarification about the, you know, regulatory writing process, promulgation process. If we propose a rule that is less stringent, send it out for comment, and then want to make that rule more stringent, does that higher level of stringency require that the rule be sent out for comment again?

MR. KENNEDY: If the final rule approved by this Board and promulgation as a final rule becomes more strict than the proposed rule, we would have the option of issuing--the better course would be as to an issue on that requirement, issue a notice of comment just on that requirement and provide, perhaps, a short comment period and go to a final rule.

We could consider, also, an interim final rule and go through the same process. If timing became an issue we could go through that process but then, if the bank were to request a waiver as to the application of the existing rule, this Board could grant a waiver that would then facilitate that bank going through this process. So we've got a number of options that we could follow.

DIRECTOR MENDELOWITZ: Now if there is a rule that gets proposed as a certain level of strictness, as a modifier--

MR. KENNEDY: Yes. I understand.

DIRECTOR MENDELOWITZ: And we get comments and we propose a final rule that is less strict, does that have to go out for comments again?

MR. KENNEDY: No. If it's less strict, less onerous in terms of the entities covered by the rule it would not have to go out again for comment.

DIRECTOR MENDELOWITZ: Okay.

MR. KENNEDY: And the theory, I think, was determined--I think logical outgrowth. If the final rule, as drafted and approved by this Board, if there are any changes, but they're logical outgrowths of the proposed rule, no need at all for any further rulemaking.

DIRECTOR MENDELOWITZ: The reason why I ask that is that this rule is a permissive rule rather than a rule that requires certain things.

MR. KENNEDY: Correct.

DIRECTOR MENDELOWITZ: If a bank wishes to assess its needs and implement the permitted activities here they can do so, but it is not required--

MR. KENNEDY: It's not required.

DIRECTOR MENDELOWITZ: But the key issue that this proposed rule--sorry about that, I forgot to turn this on. The key issue that this proposed rule lays out and then asks a question about is whether the fundamental assessment, the permissive would be required--

MR. KENNEDY: Correct.

DIRECTOR MENDELOWITZ: And we specifically ask the banks whether this should be required. And I think we're dealing with a timing issue here. The intent, as I understand it, is to try to get a rule promulgated so that it would be in effect before the next election cycle for elected Directors.

MR. KENNEDY: Correct.

DIRECTOR MENDELOWITZ: And if that's the case, and given the answer that you gave to my earlier question, with respect to what happens if you make a proposed rule more strict than the final, or if you make a proposed rule less strict than the final, it seems to me, based on your answer, the better course of action so that we have no regulatory promulgation issues is to propose something more strict. Ask for comments on whether it should be less strict so that if we choose to proceed with the more strict rule, we can promulgate it in final form after the comment period without difficulty. And if we choose to make it less strict, then we also don't have any issues with promulgating the rule.

So, I would suggest that we amend the proposed rule to require the assessment and to require the process that's laid out here and then ask for comments on whether it should be required or not so that the final rule, if we wish to make it required, doesn't present promulgation issues. And if we want to make it less strict, it doesn't present promulgation issues.

MR. KENNEDY: Again, the rule, in its present form, the draft rule, is permissive. If, during the comment period, we get sufficient comments and this Board elects to make this a requirement as opposed to permissive we still have the option--if timing really was an issue, and I'm not sure that it would be, because it's a 45 day comment period, it's April, I think there's probably enough time to do all of that.

The Board could go final with a permissive rule, put out a proposed rule that would make it a requirement. In the meantime, those banks that wished and made the election to use this process could do so. Those that, at that point, have not decided they want to do that or need to do that, would not avail themselves of this process, but we could still put out a rule that makes it a requirement and go through a short comment period.

I mean, you can do it either way. In the sense that what we are trying to do here is take into consideration the horizontal review process, the findings in that review. We're also taking into consideration that we have requests from a number of banks, but not all the banks. So, at this point, we're trying to address that issue in a way that's most consistent with the bank's wishes. Again, I think as Alicia pointed out, it is ultimately their process. It is their bank. It is the members who should decide who is on their Board of Directors.

I think to make it a requirement, at this point, number one, is unnecessary, and number two, is not consistent with the inputs that we have received so far from the banks.

DIRECTOR MENDELOWITZ: Right. I would say, first of all, my view is that it's not our job to do for the banks what the banks want. It's our job to do what we think is important to enhance the safety and soundness and mission of the system. So that if the banks put forward a proposal that seems like a reasonable proposal and we think that it would assist and strengthen the safety and soundness of the system, then we should make it a requirement.

We shouldn't say, because some banks didn't ask for it, they don't have to do it. This is an issue of what our responsibilities are as regulators.

MR. KENNEDY: Correct.

DIRECTOR MENDELOWITZ: Of the safety and soundness of the system. Secondly, the horizontal review of corporate governance clearly identifies weaknesses in corporate governance. And at the end of the day the first line of defense of a safe and sound system is sound corporate governance. And I think that we should be taking action, however limited this action is, that clearly holds out the possibility of strengthening the capability of the Boards of Governors of the banks. There will be responsibilities in corporate governance.

So, I personally would rather see this proposed rule amended to make this process required. Ask for comments if, in fact, there are good reasons why it shouldn't be required. We could consider that when we adopt the final rule. But I would like to see this proposed rule amended.

CHAIRMAN ROSENFELD: Any other comments?

Director Leichter?

DIRECTOR LEICHTER: Yes. I would just say in response to your comments Allan, that my impression is that most banks will take advantage of the authority that is given them if this rule continues to be a permissive rule. I mean, I think the comments we have heard from the banks about their governance needs, I think will lead them to take advantage of the provisions of this rule. I think if you make it mandatory--I think that if there are some banks--if it remains permissive, it would not take advantage of this--I don't know whether you would get them to necessarily give it the care and consideration we would like to see in any event.

I think the purpose of this, clearly, is to improve corporate governance. I think we're giving the tools to the banks. I think they'll take advantage of it and I think leaving it permissive I think you're more likely, I think, to get the banks to deal with it in the considered fashion that we would like to see. I would just say if we have a final rule and it remains in this form and is permissive, and should we find that banks are not taking advantage of this and that the corporate governance of the banks doesn't meet the standards that we would like to see, we could certainly change the rule at that time.

CHAIRMAN ROSENFELD: I must tell you that I had gone both ways on this. I started out being a strong advocate of the rule as it was not permissive. I thought, Allan, your comments were really quite persuasive. So for a few moments, I said, well, maybe we ought to go the other way. I'm kind of drifting back--I'm an incredibly weak chairman.

[Laughter]

DIRECTOR CASTANEDA: You cannot have it both ways.

CHAIRMAN ROSENFELD: Maybe I can. You don't know.

Listening to Franz--it occurred to me that, you know, you're going to spell out certain needs amongst the banks by virtue of a study or something.

You're going to have certain requirements of accounting, corporate finance, whatever. But, let me give you an example. I think the Board of this--people that sit on this Finance Board would be a marvelous Board of Directors for a Home Loan Bank, but none of us, to my knowledge, have--well, we're technically lawyers, Franz and I--but none of us fit into a slot that is prescribed in the study.

Now, we may be generalists, which I think we are. We may be intelligent people, which we are. We may be knowledgeable, which we are, but I think that we could be a wonderful Board. But if we happen to sit on the Board of the Bank of the--whatever--would we somehow, because we don't fit the criteria not be reelected. Now that particular bank might well say, we don't need a study. We've got a very good functioning Board here, that, despite the fact it doesn't have people in certain categories, this thing works very well. Let's leave it alone.

So, now I'm back to Franz's point. Let's make it permissive and see where we go.

Any other comments?

Brian, is it--

Without comments I guess we could--

DIRECTOR MENDELOWITZ: I would like to respond to Franz's point.

When we adopt rules and regulations I think it's the responsibility of the banks to faithfully implement them and adhere to them. I never expect when I approve a rule that a bank will implement it halfheartedly. And if it turns out that a bank implements it halfheartedly, we have Director Cross's able supervision staff which will go in and hold the sword of Damacles over them for failure to implement rules appropriately.

And so I think that's really not a consideration. I really think the issue is we should adopt what we think is a good rule and if the banks fail to adhere to the good rule we have the supervision staff, whose job it is to in fact examine their conduct or systems or behavior and make sure that they have faithfully implemented it. And I have all the confidence in the world, based on the skill of the supervision staff and based on the quality of the horizontal review on corporate governance, that they would have no difficulty at all the next time they examine each of the banks to make sure that this rule, if it were required, would be carried out well and effectively.

Secondly, I'm a little embarrassed, frankly, for the Board, to be dealing with something in the area of corporate governance that's not forceful and strong. We have a statutory responsibility to appoint Directors, which we haven't fulfilled. That statutory authority and responsibility gives us the ability to appoint the right mix of people with respect to skill to insure good corporate governance. We haven't done that.

And so, to the extent that we're using a different avenue to try to assure the right mix of skills, I think it behooves us to do something stronger rather than weaker and to do something stronger to insure the right mix of skills. So I would still say that I would like to form a--I realize I'm going to be voted down four to one, but

I do want to at least go on the record as proposing that we amend the proposed rule to acquire this process and that we solicit comments as to whether it should be permissive or required.

CHAIRMAN ROSENFELD: John, is the process now--we consider the amendment that Allan proposed--

MR. KENNEDY: Yes.

CHAIRMAN ROSENFELD: --And vote on that. And if it fails to pass, then we vote on the motion. Is this a two-vote transaction?

MR. KENNEDY: Yes. I think you have to vote on the amendment first.

CHAIRMAN ROSENFELD: Does he have to repeat the amendment?

MR. KENNEDY: For the record, I think he could--

CHAIRMAN ROSENFELD: Sure.

DIRECTOR MENDELOWITZ: Then I propose that we amend the proposed rule to require this process of each bank and to amend the part of the write-up where we solicit questions to request comments on whether it should be mandatory or permissive.

CHAIRMAN ROSENFELD: Secretary, call the roll.

MS. WILLIS: On the item before the Board, Director Leichter, how do you vote?

DIRECTOR LEICHTER: No.

MS. WILLIS: Director Castaneda?

DIRECTOR CASTANEDA: No.

MS. WILLIS: Director Mendelowitz?

DIRECTOR MENDELOWITZ: Yes.

MS. WILLIS: Director Montgomery?

DIRECTOR MONTGOMERY: No.

MS. WILLIS: Chairman Rosenfeld?

CHAIRMAN ROSENFELD: Yes and no.

[Laughter]

CHAIRMAN ROSENFELD: Three and a half to one and a half.

DIRECTOR MENDELOWITZ: I appreciate any support I get.

[Laughter]

MR. KENNEDY: I would have to say that you can only vote one way, so we'll have to--

DIRECTOR CASTANEDA: I was trying to say that.

MR. KENNEDY: You only get one vote.

DIRECTOR CASTANEDA: Good try, though.

CHAIRMAN ROSENFELD: Having been put down once, we need another motion, right?

MR. KENNEDY: Yes. In terms of the--

CHAIRMAN ROSENFELD: Who makes it?

MR. KENNEDY: Whoever wants to make it.

DIRECTOR LEICHTER: Okay, I move the adoption of the proposed rule.

MS. WILLIS: On the item before the Board, Director Leichter, how do you vote?

DIRECTOR LEICHTER: Yes.

MS. WILLIS: Director Castaneda?

DIRECTOR CASTANEDA: Yes.

MS. WILLIS: Director Mendelowitz?

DIRECTOR MENDELOWITZ: Yes.

MS. WILLIS: Director Montgomery?

DIRECTOR MONTGOMERY: Yes.

MS. WILLIS: Chairman Rosenfeld?

CHAIRMAN ROSENFELD: Yes.

Okay. The motion is adopted. This will end the open session of the meeting, we will reconvene in about three to four minutes.

[Whereupon, at 10:25 a.m, the open session concluded.]