

STATEMENT OF
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TO THE
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
OF THE
UNITED STATES SENATE

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Good afternoon Chairman Shelby, Ranking Member Sarbanes, and Members of the committee. I am Norman B. Rice, President and Chief Executive Officer of the Federal Home Loan Bank of Seattle.

I'd like to start today by underscoring the critical importance of this committee's work – and that of Congress and the Administration – in supporting a world-class regulatory structure that ensures and enhances the safety, soundness and economic viability of the housing government-sponsored enterprises (GSEs).

In my role representing the Council of Federal Home Loan Banks before this committee, I wanted to very clearly state our support of this effort. The Bank System should – and must – at all times lead by example in terms of pursuing the highest levels of oversight and public accountability.

This committee is to be commended for the thoroughness of the process and efforts regarding the creation of a new regulatory structure for the housing GSEs. We believe the strong, independent structure being discussed can serve the Bank System -- and the more than 8,000 community financial institutions we serve – appropriately, and we stand committed to working with you in this effort.

The Home Loan Banks are also acutely aware of how much is at stake in this process for those who struggle to make ends meet and find safe, affordable housing in communities across our country every

day, for American residents and taxpayers, and for our member shareholders.

We understand that this committee is considering the creation of a new agency. If so, it is imperative that the agency you create improves the oversight, the mission delivery and the effectiveness of the business activities of the housing GSEs -- not hinder them.

When I testified before this committee in October 2003, I outlined a set of four principles that framed the Bank System's bottom-line needs regarding a new regulatory structure for the housing GSEs. These continue to be the key elements we believe must be included in legislation in order to create a world-class regulator.

What I put forth, in essence, were the pillars on which the Bank System cooperative rests -- the elements that allow our 12 banks to provide more than a half trillion dollars each year in advances to our member shareholders; that allow us to issue more than \$150 million in Affordable Housing Program grants to communities across America; that allow us to provide more than \$9 billion annually in reduced-rate loans for the purpose of community and economic development that benefit low- to moderate-income families and neighborhoods.

Critical to what must be contained in a regulatory structure? Yes.

Critical to the economic health of the communities our member shareholders serve? Yes.

Those Bank System principles include the following:

Number 1-- Preserve and reaffirm the Bank System's mission.

Mission is everything to us. We strongly believe that any legislation should accomplish the following:

- Provide cost-effective funding to members for use in housing finance and community development.
- Preserve our regional affordable housing programs, which create housing opportunities for low- and moderate-income families. Since the inception of our Affordable Housing

Programs in 1991, the Bank System has contributed more than \$1.7 billion in grants to communities across America.

- Support housing finance through advances and mortgage programs.
- Preserve the Bank System's ability to bring to market innovative new business activities that advance our mission without creating a cumbersome process that prevents us from responding in a timely way to the needs of our member financial institutions.

Number 2 -- A strong and independent regulator.

Safety and soundness of the Bank System is our No. 1 concern. This is absolutely consistent with the role of other bank regulatory agencies, in which the regulator responsible for safety and soundness has free and unfettered authority to determine policy, rulemaking, application, adjudicative and budget matters. It is essential that this regulator have the independent authority to promulgate rules and perform its safety and soundness role without undue outside agency interference.

Number 3 -- Preserve Bank System funding.

It is critical that we ensure that nothing is done that increases the Bank System's cost of funds and, correspondingly, increases costs for consumers and financial institutions.

Therefore, any legislation must:

- Preserve the role and function of the Office of Finance and clearly establish it as an entity of the Federal Home Loan Bank System, regulated and examined by the System's regulator.
- Ensure that neither the U.S. Treasury, nor the independent GSE regulatory unit, has the ability to impede or limit our access to the capital markets without cause.
- Not limit the financial management tools available to prudently manage the financial risks inherent in our funding and business activities.

Number 4 -- Preserve the unique nature of the Bank System.

While all three GSEs have much in common, we believe it is important to both recognize and preserve the unique nature of the FHLBanks.

Therefore, any legislation must:

- Preserve the cooperative ownership of the Bank System and the joint and several liability that is the underpinning of the Bank System.
- Preserve the unique regional structure of the 12 banks that assures we are locally controlled and responsive to the financial and economic development needs of our communities.

I also would like to speak more specifically to the regulatory structure we understand is under discussion – that of an independent agency that operates outside of a cabinet-level department.

I will present to you this afternoon the Bank System's view on the following aspects of this proposed structure:

1. Ensuring regulatory independence.
2. Agency oversight responsibilities.
3. Creating separate divisions for the Federal Home Loan Banks and the publicly-traded housing GSEs.

1. Ensuring regulatory independence.

A regulator lacking true independence is often subject to a wide range of demands and influences that we believe would be detrimental to the supervision, business activities and mission fulfillment of the housing GSEs. The regulator of this new, proposed agency must have a laser focus on following the will of Congress in assuring fulfillment of the mission and the safety and soundness of the housing GSEs, not the agendas of outside agencies and other political influences.

We know that some have discussed the possibility of an advisory body in addition to or as a part of this regulator. The Bank System understands the potential value of a board or advisory committee, and the regulatory role other cabinet-level departments have played

in the past. However, it is important that the new “world class” regulator not be hamstrung by a cumbersome board structure, and not be dominated or controlled by any single agency represented on the board. This new regulatory body must have the authority to govern – promulgate rules and perform its safety and soundness role.

2. Agency oversight responsibilities

The Bank System believes this independent regulator should have the following authorities:

- Ensuring the safety and soundness of the housing GSEs.
- Overseeing all mission-based goals and programs.
There are obvious differences in the mission-based goals and programs for the two housing GSEs and the Home Loan Banks.

We are required to annually contribute 10 percent of our net income for affordable housing grants, while Fannie Mae and Freddie Mac have affordable housing goals.

However, we believe a proposed new regulator should have the authority to review, approve and monitor all mission-based goals and programs.

Though we appreciate the goals the other housing GSEs maintain, we believe that in addition to greater consumer access to credit, one of the best ways of passing along our subsidy is through our Affordable Housing Program and the direct 10 percent contribution made by each of the 12 Home Loan Banks annually.

In addition, our current regulator has that mission-oversight authority, and we believe it has served the Bank System, its members and their communities very well.

- Setting capital standards.
Along with independence, any world-class regulator must have the authority to set both leverage- and risk-based capital standards. As you know, Congress conducted an extensive review and revision of our capital structure in the Gramm-

Leach-Bliley legislation, and the Federal Housing Finance Board was given this broad authority in the Act. We believe any new regulatory agency should have the authority to raise and lower capital requirements as deemed appropriate and necessary. Anything less, in our opinion, would be a significant step backward.

- Approving new business activities and programs.
Having the capacity to innovate and keep pace with an evolving financial services industry is critical to all 12 Federal Home Loan Banks. We believe a world-class regulator should preserve the Bank System's ability to innovate around existing products and services. In turn, the regulator ought to be diligent in examining and approving these innovations and exploring areas that represent new risk to the GSE.

Speaking on behalf of the Seattle Bank, I believe our Mortgage Purchase Program (MPP) is a good example of where a regulator insisted on close oversight and then approved a new business line. This new activity was and remains fully consistent with our mission and the statutory authority Congress conferred, but prior review was appropriate because it entailed substantial new risks.

Likewise, going forward, the new regulator should enjoy and exercise the same authority to approve innovation. In turn, a Home Loan Bank should be expected to demonstrate, first, that it has the capacity to manage the business before it is allowed to incur substantial new risk. Since nothing is static in financial services generally -- and housing finance in particular -- it is incumbent upon the regulator and regulated alike to remain vigilant. To that end, we continue to strengthen our internal infrastructure in an effort to better manage the risks of this new business, which has proven to drive significant value back to our member shareholders and lower housing costs for consumers.

3. Creating separate divisions for the Bank System and the publicly-traded housing GSEs.

While Fannie Mae, Freddie Mac and the Home Loan Banks all share GSE status, we are, fundamentally, very different entities.

The Federal Home Loan Banks are cooperatively owned and capitalized by our members, most of whom are community banks occupying and delivering benefits to Main Streets across the country, while the other two housing GSEs must meet the quarterly earnings expectations of Wall Street investors.

To that end, the Bank System believes that creating separate divisions within a regulatory structure would add efficiencies in the provision of appropriate oversight and supervision. Our assumption is that staffing from previous regulatory agencies – such as the Finance Board and OFHEO – could be retained to provide a baseline of expertise for the two divisions.

In concluding this afternoon, I want to emphasize to the Committee that the onus for strengthening our system lies not only with Congress and regulators, but with the housing GSEs themselves.

We must be willing to take the steps necessary to efficiently manage our financial institutions in a safe and sound manner, and provide world-class financial transparency and disclosure regarding our business operations.

The Federal Home Loan Banks unanimously support providing enhanced, comprehensive and fully transparent securities disclosure. On that point, there is no debate.

Where there is a difference of opinion among the banks -- and where there has been much discussion with our regulator, the Federal Housing Finance Board, and others -- is concerning who should have authority over financial disclosures and transparency: the Securities Exchange Commission (SEC) or the housing GSE regulator.

From the Bank System's perspective, we believe that a world-class regulator with the experience and expertise to oversee the housing

GSEs would, potentially, be better able to set the framework and supervision for the level of financial disclosure now being demanded of our system.

If Congress' intent is to create a new, independent regulatory structure for the housing GSEs, why not invest the agency with the authority to oversee financial disclosure? Why not accommodate in this new framework the resources and expertise to supervise financial disclosure that conforms to SEC standards, yet fits appropriately within the Congressionally-mandated scope of the housing GSE charter and mission?

We would respectfully request that this Committee consider this as an option as you continue your regulatory restructuring discussions for the housing GSEs.

However, if Congress were to choose the SEC to regulate these financial disclosures, the Bank System believes some very specific accommodations would be necessary.

The banks have identified financial, operational and legal considerations that could lead to uncertainties and risks to the system and adversely affect their ability to carry out their Congressionally mandated housing finance mission.

As just one example -- issuer stock-repurchase requirements.

The purpose of this requirement is to provide adequate information to the SEC, the holder of an issuer's equity securities, and the marketplace of a potential change in control when an issuer repurchases its own shares.

The Home Loan Banks routinely repurchase the excess stock of their members. All repurchases must be made at par value. Repurchase transactions often occur on a monthly basis, although they may occur more frequently than that, at the initiation of the FHLBank or at the request of a member shareholder.

The ability to repurchase excess stock of members enables our banks to manage their capital position in view of prevailing market

and business conditions, consistent with Federal Housing Finance Board requirements.

Repurchases of excess stock cannot result in the change of control of a Home Loan Bank, nor can they benefit one member at the expense of another, because all transactions must occur at par value.

Accordingly, no investor protection purpose would be served by requiring the Bank System to comply with the issuer-repurchase requirements of the federal securities laws. Moreover, the application of such requirements would result in costly and unnecessary filings, in view of the volume and frequency of bank repurchase transactions.

Again, this is just one example – of several – illustrating the unique nature of the Bank System and the significant financial, operational and legal challenges created when considering SEC registration for our 12 banks.

However, it is important to note that the Bank System's ongoing questions and discussions have not prevented our institutions from working with SEC staff over the last year on the process of registering under the 1934 Act – a process driven, in large part, by proposed rulemaking through the Federal Housing Finance Board.

A Task Force of the Bank Presidents' Conference, as well as some individual banks, have had a number of meetings with SEC officials to discuss the resolution of outstanding accounting and reporting issues.

In addition, the Seattle Bank Board of Directors, at our September 2003 meeting, adopted a resolution calling for SEC registration, pending resolution of all reporting and accounting issues. Our individual banks are also investing significantly in staff and resources in order to conform to SEC and Sarbanes-Oxley disclosure requirements.

If it is the will of Congress for the Home Loan Banks to complete SEC registration, we believe we are moving in the right direction to make that happen in an appropriate timeframe -- and in a way that maintains our ability to carry out the Bank System's Congressionally mandated housing finance mission.

After all, that's why the Home Loan Banks exist – to provide flexible, long-term financing that helps our member shareholders fund the hopes, dreams and critical needs of their communities.

As you move quickly forward in this legislative process, I would ask that you keep top of mind that we are a cooperative system owned by more than 8,000 banks, thrifts, credit unions and insurance companies. That means every dollar of value we create is passed through to our members and their communities. That's why the Bank System exists.

We look forward to working with you in strengthening our cooperative and the oversight and supervision of the housing GSEs – for the good of the American public, our communities, and our members.

Thank you for your time this afternoon. I would be happy to answer any questions you may have regarding my testimony.