FHLBank System at 100: Focusing on the Future Roundtable Discussion – Boston, MA - 03-13-2023

Please note that this transcript reflects corrections to inaccuracies in the real time closed captioning in the roundtable video

Chris Bosland: Good afternoon and welcome. This is the 16th and final in-person round table event for the Federal Housing Finance Agency's Federal Home Loan Bank System At 100, focusing on the future initiative. We are here today in Boston at the Kennedy School. Thank them for hosting us. Although as a graduate of several other institutions, I feel a little bit in enemy territory, but they've welcomed us. Very friendly and I appreciate that. We are going to discuss today Federal Home Loan Bank corporate governance and system structure. We have at a distinguished panel, including regulators, former regulators, scholars. We had to do... One note, we did have some other attendees who had to drop out at the last minute. So, we've got a little extra time to hear your brilliant thoughts and ideas for the future of the home loan bank system. Just as usual, this event will be live-streamed and will be recorded and available on our website. And I encourage those of you to check this one and prior events that were held, all information can be found there, and I encourage you to visit there. So welcome to the participants and we look forward to the discussion. I'm joined today by Eric Howard, who is a principal policy analyst at FHFA, and Home Loan Bank expert and he is going to discuss the rules of engagement.

Eric Howard: Great, thanks Chris. As Chris said, I'm Eric Howard and I will be helping to moderate the discussion today. We hope and expect that we will have an open and engaging discussion. And with that we'd like to say that no recommendation or view should be considered off the table and we encourage you to offer differing views about some important questions that we will be covering this afternoon. First, we want this to be orderly. As such, we will ask that everyone turn their name placard to the side when you would like to respond so that we'll know to call on you. And we will call on each of you in turn, and we ask that everyone engage in the discussion in a respectful manner, knowing that we will likely not agree on all points. And to ensure that everyone has a turn to speak and that we cover every discussion topic, if someone is going a little too long, we may interject to keep the conversation moving. Second, this review is meant to bring forward the views and reason perspectives of Federal Home Loan Bank systems stakeholders and to highlight areas for further consideration. We ask that you not limit your responses to what would be possible under current conditions. Third, we will have a break roughly halfway through today's event. And finally, for the benefit of those in the audience, the round table participants have been given a list of prompts that we will reference during the course of this afternoon's discussion. We also have a disclaimer that we need to make you all aware of and therefore needs to be read verbatim. And so, with that, here I go. We have organized this round table to obtain your input on the mission of the Federal Home Loan Banks, including input on several specific questions that were sent to you prior to the meeting. During today's session, FHFA will not discuss the status or timing of any potential rule making. If FHFA does decide to engage in a rulemaking on any matters discussed today, this meeting would not take the place of a public comment process. The rulemaking document would establish the public comment process and you would need to submit your comments if any in accordance with the submission instructions in that document. FHFA may summarize the feedback gathered at today's session in a future rulemaking document, if we determine that a summary would be useful to explain the basis of a rulemaking. Anything said in this meeting, and that also includes reactions, nodding, eye-rolling, should not be construed as binding on or a final decision by the director of FHFA or FHFA staff. Any questions we have are focused on understanding your views and do not indicate a policy or legal position. Participants in today's round table may have a financial interest whether direct or indirect on outcomes that may affect the Federal Home Loan Banks and their businesses. As Chris mentioned, today's round table will be live streamed on FHFA's website and video recorded. FHFA may also prepare a transcript of today's session, which would include the names of all speakers and the organizations they represent, if any. The recording and any transcripts prepared will be posted on FHFA's website and YouTube channel along with any materials being presented today or otherwise submitted in conjunction with the round table. And with that, I'll turn it back to Chris.

Chris Bosland: And you can breathe. Thanks Eric. As mentioned, we've got a great panel today. We had a chance to meet briefly before this for a quick lunch, but for the benefit of those watching on the live-stream, I'm going to ask everybody to introduce yourselves. It'd be helpful if you could also state your degree of familiarity or affiliation with the Home Loan bank system. Obviously detailed knowledge of the system is not necessary, but to have great ideas about where it should go, but just it's helpful to have the ground people where you are. I will say on a personal note, it's a great pleasure to have you joined today by Steve Cross, who we worked years ago at the old Federal Housing Finance Board. And Steve was instrumental, in my view, in helping to make the regulation and oversight of the Federal Home Loan Banks much more rigorous and improved than it had been prior. So, it's a pleasure to see Steve here today. So, Steve, why don't we start with you, and we'll work our way around the table.

Steven Cross: Thank you. I'm Steven Cross. I am currently a senior advisor at Alvarez & Marsal, and I was previously the director for Federal Home Loan Bank supervision at the FHFA and as Chris indicated its predecessor agency, the Federal Housing Finance Board.

Chris Herbert: Good afternoon, it's great to be with you. I'm Chris Herbert, I'm the managing director of Harvard's Joint Center for Housing Studies and I guess something of a host for today's event. So, it's really a pleasure to have you all here to the campus of Harvard University. My own background is actually less with the FHLB system, but my direct involvement in the housing finance system is as a member of the board of directors of Freddie Mac. And so, I know the other GSEs fairly well, but less with FHLB. So, I think my experience is in governance of GSEs generally, but not so specifically with FHLB.

Chris Bosland: Great, thank you. Mike?

Mike Hansen: My name's Mike Hansen. I'm the president and CEO of MSIC. We are the excess deposit insurer for 73 Massachusetts based credit unions. We are the fourth-largest credit union cooperative in the world. We've been around 61 years. It's a success story in terms of providing full deposit insurance to consumers in Massachusetts. I will say it's a very interesting weekend to be a deposit insurer, but I'm delighted to be here. I will say that MSIC is a member of the Federal Home Loan Bank of Boston, as are almost all of our 73-member credit unions and we use their services quite frequently.

Chris Bosland: Thanks. Ed?

Ed Golding: Ed Golding. I'm the executive director at MIT's Gallup Center for Finance and Policy. Before that, I've been many years at GSCs. I was 23 years heading research at Freddie Mac, but perhaps more importantly, I was at the predecessor of the FHFB. I was at the Federal Home Loan Bank Board, which oversaw the then 12 federal home loan banks and worked for board member Larry White and attended for two years every monthly meeting of the bank president. So, it's a little bit dated, but the Federal Home Loan Banks go back a while.

Chris Bosland: Well, thank you. And I'm sure you have the scars to show for those monthly meetings of the presidents, I'm sure if it's anything like today. No. So we're here to discuss system structure and governance. As Mike alluded to, there's a few other things happening in the backdrop of the banking system in the financial sector. Obviously, that's an evolving story and it will ultimately have some impacts and I'm sure it's something that we're watching closely as are others. And I'm sure there will be plenty of postmortem assessments of what went right and what went wrong of that. But for purposes of today, I think it does underscore the importance of governance in some of the storylines that have emerged. So, I think it's at least timely and I appreciate you all coming out today.

We began these round tables talking about the mission of the Home Loan Bank System, and I take it that discussing the structure and governance necessarily entails some decisions or assumptions about what the mission is or should be. So, feel free to elaborate some of that as we go along. You don't have to feel wedded to just purely structure. But I think I would like to start with talking about of the structure the system and of the banks as they're cooperatives as we've heard. And under the bank act, the director has wide authority over establishing the districts and the structure. Some of it is set by statute, obviously. The director has authority to merge banks down to a certain level. The banks can voluntarily choose to merge if they did. It's not necessarily clear that merger is good, bad, or otherwise, but that be something you want to talk about. But Steve, given your direct involvement as a regulator, I mean we'll start with you. Do you think the systems appropriately structured to enable it to fulfill its mission?

Steven Cross: No.

Chris Bosland: Okay, Chris?

Steven Cross: If I say anything that leverages materials that Ed Golding distributed early, I apologize. I don't want to take any of his thunder, but I thought he had some good ideas. I mean, it's first question that I have, and this was one that Ed did raise, was whether we need to have 11 districts or whether it would be better to have a more centralized organization with branches with one governance structure. So, I think that's a question that at least needs to be posed. Secondly, the requirement that each state be represented on the board of directors of a Home Loan Bank has always given me pause. It is a reason why in the past mergers have been difficult to effectuate because the result is additional states, larger boards. The Des Moines board is, I believe, 22 members right now. And I suspect that that's larger than an effective size for any large organization's board of directors. Related to that, you have elections by state that are often very closely tied to state banking or trade associations. And there's this sense that the member is representing the entities in its state. I've always objected to that notion. All of the members should have the fiduciary interest of the Home Loan Bank writ large at mind, not the parochial interests of the member banks. So those are a few thoughts I have in response to your questions.

Chris Bosland: Okay, thanks. And we'll certainly get into more about the board structure and the processes. That's going to be a heavy focus today. But I noticed you posed the question about consolidation, but you didn't actually answer it. Or was that intentional?

Steven Cross: Well, I do think that it would be better to consolidate, yes. In the world we live in today, I appreciate the value of local representation, but you can have branch offices and you can provide local services without having a separate structure in place, a separate organizational structure in place in each of 11 or previously 12 or if it were to reduce, I don't see that that's a particularly efficient way to go.

Eric Howard: Steve, with consolidation, is that consolidating down to one bank or is that a West bank, an East bank? I mean, do you have any thoughts on that?

Steven Cross: Well, again, I welcome you asking that question to Ed Golding because he did in our pre-meeting conversations, raise that issue. And my answer to your question is I think there needs to be consolidation. I don't see any reason why it couldn't be one with separate districts, but with a core organizational structure. And without going too far into this, I mean really think it's even tied in some ways to what we're seeing today where you have the Federal Home Loan Bank of San Francisco making advances to... Or one organization that had a heavy tie to cryptocurrencies, another that had gotten itself into liquidity issues by virtue of its portfolio of securities investments in a rising interest rate environment and with joint and several that affects Boston, Indianapolis, Dallas, you name it. But they don't have any say about that. So, consolidating down, I think, achieves some of that. I can't say that I've done an analysis that tells me it has to be one rather than two or three. So, I'll stop there.

Chris Bosland: Well, Ed, you've been teed up. Would you like to express your own views in your own words?

Ed Golding: Well, I'll just agree. I don't think any of these were... Many of these had been discussed for many years. Some of them were discussed when I was at the bank board over 30 years ago. So, I'm sure there are many authors. I always like to sort of start out just with the, I like geography. I always ask people how many contiguous states have Federal Home Loan Banks in them? So, I'm going to do a quick, anyone want a hazard on this expert panel? States that touch each other that each have... How many states can you go across the country and visit a Federal Home Loan Bank?

Mike Hansen: I mean, I would guess zero are in contiguous states, but I'd have to hold up on the western states that are much larger. There might be some closer ones out there. I'm not sure.

Ed Golding: Quickly. Yeah.

Chris Bosland: Well, we're not supposed to answer the question, so I'm going to [inaudible 00:16:18] at least one-

Ed Golding: These are factual.

Chris Bosland: But I have to think more about it.

Ed Golding: More than one. [inaudible 00:16:25]-

Steven Cross: I'd say four.

Ed Golding: And the answer's seven. So, for those of you who do geography, we're in Boston. If you just head down the turnpike, you can get to the state of New York. From there, New York borders Pittsburgh or Pennsylvania. Pennsylvania borders my home state of Ohio. Shout out to Cincinnati. Indianapolis, Chicago, and Des Moines. So, you can get to seven of these. Very much a creature of the geography and the politics of 1932. Again, nothing necessarily wrong with that, but it's probably not... If you were to start with a blank sheet of paper, you probably wouldn't have 12 of them or 11, you probably wouldn't locate them where they were. I mean, it was a very different country in 1932. I also go back to what I think of as a successful example is the Office of Finance is one office that deals with much of the operation of the Federal Home Loan Banks. Not all of it, but much of it is centralized into one office and they do the debt and the capital markets. And so, the question is, can't advances just sort of given technology, why can't the whole advance infrastructure and the tech and the payroll infrastructure, why do you need 11 separate ones? So why not build towards the one? Now whether how you get there... But if you were envisioning a system, you clearly want to keep the local connection. But lots of... Walmart knows how to build local connections to its communities out there. So, you can keep, I think, the local connection and still have the efficiencies of modern capital markets. And I think that's what you would want to build to if you were to start over 100 years later.

Chris Bosland: Okay, thanks. Mike, your organization's a cooperative, I think you mentioned-

Mike Hansen: Yes.

Chris Bosland: And your members are themselves smaller, but do you have any perspectives, not maybe on consolidation, but more generally on the cooperative structure, the bank system as well?

Mike Hansen: Before we leave the consolidation, let me just touch on that. We have to remember what the purpose is. And the purpose is advancing a deep, rich housing market that can promote home ownership for Americans. Now that's how I view it, because that's the easiest way to create personal wealth among our people. And so, the purpose of facilitating a robust housing market, I think, is the primary purpose of the FHLB system. Now, when you think about that, in the modern era, we have to think about lending. What is lending really like and how does it really work? And in our modern era, there's absolutely no reason we couldn't have just one of these centralized in Washington and everything is technologically done, and all the advances are done online. And at the end of the day, I would have to ask you, "is that what we want?" Can we, do it? Yes. Is it more efficient? Yes. Would it save on payroll? Yes. But if you are in northern Maine and you need an advance because you've got a particular housing problem, I will guarantee you that the folks in Washington, all good people, aren't really going to understand the boots on the ground reality of that housing market because America doesn't have one housing market. It has overlapping housing markets with different needs. And I will tell you that Boston has a different need than Brooklyn. And yes, the states are contiguous, but having a federal home loan bank system that is diverse and that all states are represented on the board, I think is a very good thing if the goal is to improve our housing market. Is it the most efficient? No. Is it the easiest? No. Is it the easiest to regulate? No. But is it giving us the right result? And I would just say, if you've ever been in a small community that doesn't have a local bank or credit union and you are going to go to Bank of America, I shouldn't pick on them. They're very good. Are you going to a large money center bank, if you make the algorithm, you get the loan? If you don't make the algorithm, you don't get the loan and you got no one to talk to. The reason we have such a diverse banking system is that we have overlapping markets with different needs, and we need local judgment to be able to make good lending decisions that promote our economy and promote our housing market. So, I understand exactly what you're saying, and I understand the efficiencies, but in the end result, I think we want to have a very diverse system making these advances because the housing market, even within New England, the housing market is quite different in Vermont, Maine, Connecticut, it's a whole different cat. And I think having those housing interests represented is really important. Now, I didn't say that the banking interests in those states all need to be represented, but the housing people do, and the bankers and the credit union folks are there to represent housing interests because that's mostly what they do. So, I have a little bit different take on the consolidation.

Chris Bosland: Well, I want to get Chris in here, but maybe we'll come back because I thought what I heard, Steve, and to lesser extent Ed saying, was that you could have regional offices or regional focus, but under one consolidated thing, governance structure, but we can come back to that. But Chris?

Chris Herbert: Yeah, that's what I was just going to suggest, is that we talked about what the mission is and its liquidity and either housing affordability, housing affordability, community development, and the kind of things that Mike's talking about. And I think one of the strengths of the system are the advisory councils that have a root, each bank, in some representation in the communities. And so, thinking about a structure where you still retain that voice. So, it's hard to do that on a national basis. So, the regional structure would do that. So, the devil's in the details. So, I think if you can figure out how to consolidate the aspects, the mission of the bank that it benefits from those economies of scale, but then allocate to the regions the strengths that it has in terms of the mission. So, I think the details are in what are the authorities and responsibilities of the regional banks? And what you'd like to have been some ability to innovate and some ability to come up with solutions that are unique to that area. And so, have some sort of financial independence in the sense of how do they develop programs and the responses to the community, at the same time answering to a national bank? So, there might be some way to cut the baby in half to achieve both goals. But I think Mike's point is really well taken is that the strength of the system in part is having those local communities. And how do you make sure those aren't lost in something that would get nationalized?

Chris Bosland: Good-

Ed Golding: Yeah, clearly the strength of the community bank and the community banking system is not what we're challenging. And the role of those community banks of knowing their local community is important on that. I think the question, they all offer checking services, but they all go to one or two providers to help them process those checks to get to the Fed. We don't have a system where each community bank comes up with 12 different ways of processing a check. And I think it's we've done it on the debt side with the Office of Finance. And the question is, and pledging the collateral and getting the money, what needs local knowledge in terms of processing that? No one is sort of... Well, we'll come back to the affordable housing programs in a moment because there's some more locality there. But the bread and butter of what the Federal Home Loan Banks were created for in 1932 was when we had mutual SNLs from mutual savings banks that had no sources of funds, and we had to basically liquefy them. They had mortgages, the five one mortgages. It was a very important mission. And that's that mission still exists today, which is how do you make sure that they have access to low-cost funds that the Federal Home Loan Banks can provide? But it's not clear to me that you need local knowledge on terms of what's good collateral. Everyone's using the same mortgage documents for a variety of reasons. You should be able to figure out how to get collateral, how to manage the risk of the system. And I wouldn't do it centrally in Washington. I was going to do a shout-out for Consolidated in Cincinnati because that's my hometown.

Chris Bosland: I like that.

Ed Golding: So yeah, we can scribble with the details of where to locate it, but I think you can provide all those services. When you think of the basic bread and butter, you're not asking them to take over the lending decisions because that's not what they do. It's really just the what's good collateral? Is this a safe advance to make? And is this the right product? So, we'll talk a little bit more about housing and supporting affordable housing in a moment. But I go back to what Chris says. I think this can be done in a way that doesn't challenge the community bank model. And I think people are afraid that it is sort of like if you go after this, you're going to go after community banks as the next move now. And I think it's important to at least separate that or at least try to separate it and say, "no, this is not about going after community banks. This is about trying to provide better services to community banks."

Chris Bosland: Good.

Mike Hansen: So that's not what I'm saying either. I'm not worried about the Federal Home Loan Bank consolidation going after community banks because banking, whether it's community commercial, credit union, is so much bigger, so much more robust than most people think, that the consolidation of the Federal Home Loan Bank system will not really have anything to affect them. That wasn't what I was trying to imply. I think the system can have consolidation in its functionality, which we've done on the security side already. You can do one personnel for seven banks, 11 banks. You can do all of these functional things to get those efficiencies, but you can maintain local control in the decisions about housing. And one of the problems that I see in this debate, and I never been a board member, is housing is not just affordable housing. Don't get me wrong, affordable housing's incredibly important and the things that we need to do.

But housing is an environment, it's an ecosystem. The housing markets today are so complicated, so deep, so rich, having a functioning wholesale funding market like the Federal Home Loan Banks provide into the banks in the region, allows them to be profitable, allows them to provide more home mortgages, allows them to stay in business in a way that brings services and small business services to their community. It's not the old business of making a loan and closing it and funding that particular loan. The Federal Home Loan Bank system supports an ecosystem that gives us a housing market that's probably, in my judgment, the envy of the world. And we want to keep that wholesale funding structure there to support it, but to know what's wrong in a housing market, not just affordable housing, but to know what's wrong in a housing market, you really need some local control. Now, I'm not saying 11 is the magic number, but I think consolidation, you start to lose those local voices about what is needed in a certain market. If you go back to the series of banking crises that we had in the early '90s, you saw that they rolled in waves. There was Texas, there was the sand states, and if anyone remembers those days, there was Boston and the New England banking crisis. These types of issues adversely affect the housing market. And local control is extremely important in anticipating it, responding to it. And you can't do that from afar. So, it's more than just supporting local banking because that's not going anywhere because Americans love it and they're going to continue to use it. So, you're going to have the big banks and you're going to have the community banks. But I think the Federal Home Loan Bank system, the way in which we respond to housing environment needs, has to have a high degree of local involvement at a decision level, which is the other organizational issue. I mean, we're talking about two different things. We're talking about the functionalities of the system, which should be centralized, perhaps more, especially on the risk side. But when we're talking about the decision making as to what the overall housing needs are, you got to have local folks in control to make those local decisions. Last point, the risk factor today in Silicon Valley is a lot different than the risk factor today in Boston. And those differences, I think, would promote a diverse system with diverse leadership in different areas of the country.

Chris Bosland: Thank you. Steve, you had turned your card. I don't know whether you retracted, thought better of it, or still want to get in?

Steven Cross: No, I'd like to get in. I actually think one of Mike's most provocative observations is that the-

Steven Cross: ... provocative observations is that the central role of the Federal Home Loan Banks is to promote a robust housing market. That was its role, and in fact, it is one of its roles according to the Council of Home Loan Banks now. But it's not its only role. And according to the Council of Home Loan Banks, in addition to providing members with a reliable source of funding for housing finance, community lending, and asset liability management, as well as liquidity for members' short-term needs. I think that what we've had, and it's partly a result of statutory changes that have expanded membership to commercial banks and other entities, aside from thrifts, is that the role of the Home Loan Banks has gone far afield of this robust housing market that Mike talks about. And so, as the agency looks at the future of the Federal Home Loan Bank system, I think one of the key issues has to be, what should be the function? As far as the issue of local control, I mean, I may be totally wrong about this. I appreciate that notion. It comes up in the election of directors by state, et cetera, et cetera. I mean, does Portland today have local representation? It's part of the Federal Home Loan Bank of Des Moines. I don't know, it might, but I'm not sure that someone in Des Moines has a better feel for what Portland needs than the person in-

Ed Golding: Portland, Oregon.

Steven Cross: Portland, Oregon.

Ed Golding: We're in Boston here. There's another Portland. [inaudible 00:33:11]. I was in Maine.

Steven Cross: And I look at the business of the banks, the Seattle Bank ... When WAMU failed, WAMU accounted for a third of the advances. One member. That member was represented on the board of that bank too. And I can tell you, was an active driver of what was going on there. Now, that's not a community bank that needs the Home Loan Banks to access capital markets. I think we hark back to 1932 when we think about the Home Loan Banks, but we're not there any anymore and I think that's part of the problem. The top 10 borrowers at each Federal Home Loan Bank ranges from roughly 50% to roughly 80% of the advances in those banks. So, we've got a system in which it's not the local community. They're getting services, sure, but I don't even think they're the focal point of these regional banks right now. Big members drive a lot of what's going on, at least that's the appearance from those data.

Ed Golding: Yeah, I just want to agree. Part of the question of governance is also what do you want the footprint of the Federal Home Loan Banks to be? And if it is to serve the community banks, you shouldn't have SIFIs being members. I mean, there's no doubt

Wells Fargo's profits, in some sense, must be a little bit better by a basis point here or there because they have access to the advances. Otherwise, they would use capital markets. But in many ways, I think of the future of the Federal Home Loan Banks is to refocus it on the community banks and to not allow very large institutions into the system. And that means a smaller system. But if it's a 300 billion system focused on community banks, that's okay. This idea that any institution has, that bigger is better, and this desire to grow, and we'll talk about the housing goals of the affordable housing programs. There's lots of reasons people want a bigger and bigger system, it's the creature of any organization, but really, if nothing is off the table, I would go ahead and restrict the membership to a certain size institution. I think in my written comments I said, SIFI's are clearly over the line. That was before everyone over 50 billion became a SIFI. And maybe that's where the line should be. But they really do need to focus, and I think if you do focus it on a 300 billion institution, they'll want to consolidate for efficiency reasons. The desire, the G & A of these institutions, or the non-interest earning expenses ... If you look at their financials, have they been roughly 15 basis points over time? 20 basis points this last year? If you are a third the size you are, all of a sudden, that's closer to 50 basis points and you can't operate the system at those expenses. And I think that alone would drive consolidation dramatically, if you think of it as a smaller footprint. So, I think there's a lot of reasons to want a smaller system.

Chris Bosland: Well, there's a couple of things in there we should unpack. I do want to come back to the affordable housing program, but I like the way, Mike, you said ... about the other issue was just because you can do something, maybe you shouldn't. But I'm curious as to your thinking, or the panel's thinking on ... I mean you made the point, Ed, that if you've a much smaller system, the members would have an incentive to evaluate whether it makes sense to consolidate. Do you all think that that's an effective incentive for that kind of decision making? Because again, the director has the ability to cause some consolidation to a certain extent if she would like but doesn't necessarily mean that it should be done that way. So, I guess I'm curious, is this a decision that you think would be left to the members to decide? Or is this something that the regulator just weigh in on? And I'm looking at Steve, but I don't want to force you into something that ...

Steven Cross: Well, the members won't decide to consolidate. I'll say that right now, the banks generally don't want to consolidate.

Chris Bosland: Even at a third of this size, hypothetically?

Steven Cross: Oh, oh, post-structural change. The reality is, that kind of structural change, which I am generally in agreement with, poses all kinds of issues for the Home Loan Banks. Not only shrinking of their assets and incurring expenses that probably don't shrink proportionately, but the fact is, large member banks that take down so many advances contribute to the bottom line of the Home Loan Banks as well. And I think that if you were to look at the data, this is what I'm remembering from 14 or 15 years ago when we were looking at this, that the large member banks more than pay their fair share of the costs of running a Home Loan Bank. So, they subsidize, in effect, the small community banks. So, while I am inclined to a agree that there's a lot of potential mischief with large member institutions using the Federal Home Loan Bank for their own short term liquidity needs, how we get there, I think, is a really tough set of discussions. Because there are so many tentacles in terms of costs and benefits that I don't think I can answer the question of, should the agency push it, or will the members be encouraged to do it by the economics? I do think Ed's right, the economics would encourage that. But then we're also stuck with the whole, I think, statutory issue of states represented on the boards. And I mean, are we going to get there with boards of 30 people? So, I'm sorry, I can't answer your question.

Chris Bosland: Fair enough. We're going to get to the question of the board in just a moment, but I think we can all agree that Congress will fix it. No, sorry. But Ed, I did want to get back to your point on the affordable housing because that's often touted as, if the system were to be smaller in any fashion, the impact on the affordable housing program. And I'd like you to just elaborate a little bit more on your thinking there. You've alluded to it a couple of times and is that the tail wagging the dog or is that ... How should we think about that?

Ed Golding: Yeah, you want the governance and the structure to follow the mission. Which, I think, and I may disagree a little bit with Mike, in terms of its role on housing and local markets. I've been in a lot of conversations around housing, and no one's ever talked about the Federal Home Loan Banks. I mean, on that. So, they're a small player in the overall funding of housing finance. They talk about the GSEs, HUD has a big role, and we can fix housing policy at another round table. Chris will host us on another one.

Chris Bosland: We'll meet at the bar.

Ed Golding: So, the main mission, I think, really is around liquidity and supporting community banks. What you don't want your governance, you don't want it to be ... what I think I wrote down is this idea, we need to cross subsidize. Everyone puts themselves in new vocabularies. We need to do this because we cross subsidize these worthy people. And I'm very much for, there's lots of things I would do around affordable housing, expanding Section 8, I can give you a long list. But this is really, that last hundred million dollars of funding into the programs, and they're great programs and a hundred million dollars is still a hundred million dollars that's not available on the HUD budget. But it's really a mistake to allow this vision of we want to cross subsidize to drive governance or mission of the organization. And there's no doubt, I've worked in these organizations, they wrap themselves in the American dream and we're doing good things. And on the margin, in a lot of places, people do good things. But you really have to understand what's your basic value added, and you have to be really laser focused on that. And you cannot grow just because 10% of your earnings go to the affordable housing program, as tempting as it is. And I think we have to really fight that, saying we need to be big because otherwise the affordable housing programs would be smaller. One thing is, I would double the 10% to 20% to reduce the shock absorber. To reduce the shock, to provide a shock absorber to shrinking the system by two thirds, if that's the number. I mean these are just round, made up numbers. So, I would increase that percentage because they're not subject to corporate income tax, et cetera. And they used to pay the rough quarter bonds, so I might add it up to 20%, but I would not have the affordable housing program drive these other issues. I think have to start with those issues and separate them.

Chris Bosland: Thanks. Anyone else want to get on this before we pivot to the board governance itself? Did you want to jump on this, Mike?

Mike Hansen: I would just add a couple of things. One, it's a small player in the housing market. It works. It works amazingly well. It provides short-term liquidity to financial institutions. I have personally, as long as it's not a risk to the system, I don't know why we would want to throw the big banks out. Because allowing larger banks to use these facilities to effectively manage their short-term liquidity needs absolutely causes more resiliency in the system. I don't see a reason to get out of it. And because it makes the overall system stronger, the Federal Home Loan Bank system is doing its part to have a resilient housing market.

Is it fixing it all on its own? Of course not. It's a small player. Fannie and Freddie have way more to do with this, as does the Fed, as does the FDIC. But we have a very important process that allows financial institutions of all sizes to have these resources. For community banks, they're accessing resources they can't access on their own. But for the larger banks, if it's fully collateralized and it doesn't create a concentration risk ... now that's a regulatory problem to me, not a structural problem. I mean we can talk about San Francisco, should that have been 80%? No, that's a regulatory issue. That's a concentration risk within that particular Federal Home Loan Bank. But I don't see the answer to be to cut out all the large banks. I don't see any real need to do that. And maybe I'm missing something on that.

Chris Herbert: I was just going to comment more on the affordable housing programs and the funding for that. I mean if we think about ... it's coming out of, really, a duty to serve. So, there's a public purpose for establishing this system, and as part of that quid pro quo, we expect the system to have some social purpose. I think the allocating of some profits towards those public purposes is a really efficient way to do it, as opposed to creating these band aids that create some sort of complex cross subsidies that people don't quite understand who's cross subsidizing who. So, I think it's a really effective way. I think Ed's point about making it larger, I would certainly support that, particularly if the system does get smaller. And I'm going to get the [inaudible 00:47:16] probably in the housing community, but if we think about the direct link between the purpose of the liquidity and the system, and what those public purposes are as we've just been discussing ... And initially this was a very housing focused system, providing liquidity for institutions that were providing primarily mortgages. So, I do think we probably needed to expand what the purpose is of that 20% of the profits goes towards. And in a day and age where we have community banks, what purpose are they playing? They go well beyond housing in terms of small business lending and other lending to the community. So, I think we probably need to have a more expansive view of what those funds would go towards. And I think this is another example where, having some sort of regional structure where there is some connection between what the community perceives as need, that's being unmet by other sources of funding, and how that money could be best deployed would make a lot of sense. And while I've got the mic, back to your point about, should we allow the system to consolidate on its own or should we give some direction? I can't imagine there's going to be a market for consolidation that will be that efficient in terms of the things that we would care about. If there's a merger, there's going to be some merger based on some convenience that makes sense, as we saw in Des Moines, and with a region that may not make sense. So, I think you probably have to think about, what structure for [inaudible 00:48:36] makes the most sense in terms of the commonality of interest? And this may be completely crazy, but it may not be state based. And so, we're going to put together Northern Maine, Mike, by your example, with Boston. What's the commonality besides what we both root for the Red Sox? And so, is there a question about rural northeast that would be more of a region? And this is where you'd have to then think about consolidating financially, because that region may not stand on its own financially. But how do we get finances from the system but have regions where we can have that control, that makes sense in terms of commonality of interest.

Chris Bosland: Ed, were you going to ...

Ed Golding: You do know, though, that the Red Sox started in Cincinnati?

Chris Bosland: And there are Red Sox fans in New Haven, so ...

Chris Bosland: Well, that's a reason to cut off funding, but I think we're getting off topic. So, let's pivot to governance itself. And I'm sure there's plenty of examples of things that are highly complicated by statute across the government, but the allocation and assignment of directors and so forth to the Home Loan Banks has always struck me as particularly complicated and convoluted. First of all, we've got member directors that represent owner institutions of the cooperative. We've got independent directors who are supposed to be independent and bring different skill sets. And then within that we have public interest directors, or yet again, we've got states, each state gets one at minimum of one and they're grandfathered by a political compromise. They can't get fewer directors than they had in 1964 or some year. So, recognizing that a lot of that is set by statute and this exercise is, we're going to get rid of all those constraints. So yeah, we'll talk about each of those groups in turn, and in your written remarks many of you commented on that. But before we talk about that, Chris, you mentioned in your introduction that you've got GSE governance background and your role as a board member of Fannie Mae and otherwise.

Chris Bosland: Freddie Mac.

Chris Bosland: Freddie Mac. Oh, sorry. We got two Freddie people, okay. My goodness. Pardon me. That's worse than rooting for the Yankees, I guess, here in Boston. And thoughts about, from that experience and where you sit now, about principles of governance. Particularly of government sponsored enterprise that we should be mindful of as we engage on this discussion.

Chris Bosland: So, the challenge in some sects is that the Fannie and Freddie, unlike the FHLBs, are in conservatorship. And so, we are operating under very special circumstances and Fannie and Freddie have slightly differences in terms of terms and how the terms are set and the like. So, in terms of selection of board members, essentially the Freddie board is largely self-selecting, with the approval of the FHFA director, which is not a small matter as our single most important shareholder. And so, in some sense, there's not that much guidance given, I think, by charter as to who should be on the board. I believe the one reference in the charter, Ed Golding would probably know this, is that there should be a home builder on the board of directors. Which is something that was called to our attention under the last director and so we actually have a home builder now on the Freddie Mac board. So, I'm not sure that, in terms of the guidance given in the charter and the like, in terms of who's on our board, there's much to point to. And in practice, what we're looking for is not unlike the list of attributes that are listed for the directors here in terms of collectively having a breadth of experience across the domains that one would expect a complicated, financial institution would have. Some of the questions that you've asked us to wrestle with in terms of diversity and the like are not explicitly discussed in the charters or the guidance. They're obviously things that we talk about with the director, with ourselves all the time, making sure we have that diversity. Which, I've gone around in circles Chris, but what I'm coming out is, I would say I'm not sure there are lessons from how the GSE's boards are currently constituted, and the rules governing what they lend themselves here. In some sense we have. In the one extreme, I think the FHLB system has a lot of prescriptions and the GSE system have much less. And so somewhere in the middle is probably the right answer.

Chris Bosland: Very Aristotelian. Yes, thank you. Well, to start with, Steve, you had mentioned a number of times the complications of these rules. Of the statutory requirements by state as it relates to mergers, right? You'd end up with a 60-member board member. If we went to one bank or something, you'd have a 60-member board. I take it from your comments, though, that generally you feel that there's a risk to extra-large, I mean board. So, what is the optimal board size, and vis-a-vis, obviously it runs the gamut to some extent from Des Moines, which is a special case following the merger with Seattle, where it's particularly large.

But in general, what do you feel the board optimal size should be?

Steven Cross: Well of course I'm going to evade your question somewhat. So, I'll first state that I don't think that rules are in any way sufficient to establish an effective board. It's all about the people on the board and their character, their questioning, their competence, and their responsibility for ensuring that the Home Loan Bank operates in a safe and sound fashion consistent with its function. Its mission. That said, when I have read studies about governance, I tend to see board sizes more from eight to 12, or 10 to 14, than 20 or 22. So I mean, I do feel like we've all been in committee meetings before and at some point, they get unwieldy. And also, as I stated earlier, my biggest concern is that the interest of the board members must be the best interest of the bank itself. And the concern I have, frankly, is that too often it's what is in the interest of the members of the institution. They are the shareholders and the customers. And so, without revisiting too extensively history that no one wants to hear about, I'll talk about a couple of things. In 2005, there was a meeting of all the Home Loan Bank directors. And at that meeting, I was there to represent two initiatives that were underway. One was anti-predatory lending policy. And the reason for that was we were starting to see that some of the Home Loan Banks were investing in MBS that were backed by subprime mortgages. Some of which we also thought were predatory in nature and then certainly poorly under underwritten. The other initiative was an effort to increase retained earnings at the Home Loan Banks. Now retained earnings play a role at the Home Loan Banks unlike retained earnings at commercial banks. And that is, because the banks are cooperatives and members buy stock, and they buy it at par and it is redeemable at par, and it's always been anticipated that it would be redeemed at par. And irrespective of statutory guidelines, often upon demand, that stock purchased by members can't absorb losses like capital is supposed to do. Because if it does, you break the buck and you can no longer redeem the stock at par. So, we had an initiative underway that the one form of capital at the Home Loan Banks that could absorb losses is retained earnings. Understand that at this point in time, there was a particular Home Loan Bank that had well over a hundred billion dollars in assets and had roughly 15 million dollars in retained earnings. This is at a time at which the New York Bank had just experienced a loss of 185 million dollars on its investments in certain manufactured housing backed securities. And I was going to each individual banks, including the Seattle bank, but all of them, saying we need to increase retained earnings. And so, you need to have a policy to do this.

Well, all I can say is that the chairman at the time, Ronnie Rosenfeld, started to give a luncheon address. He was being shouted down over retained earnings and about anti-predatory lending, and he said, "Steve Cross is back here and he's speaking to you after lunch." So that was that. I send you to the American Banker, I think it is August 25th of 2006, where a picture of me is on the front page and the Home Loan Bank directors are quoted as saying that I'm arrogant because I want them to do these two terrible things; adopt a policy that would keep them from buying securities backed by predatory loans and increase the retained earnings. And that does inform where I stand. If they are really interested in the interest of the bank, they're looking at those two issues and saying, "Does he have a point there?" Instead, they're saying, "This is going to reduce my dividends." And that's my concern about governance at the Federal Home Loan Banks is that we have to be focused on what is good for the bank, and I'm not convinced that it's the structure, independent of whether it's 10 or 22, is established in a way that has the fiduciary interest of the Home Loan Bank's top of mind.

Chris Bosland: Well, we knew it was coming. No, no, but I hope you recall that Alicia **[inaudible 01:00:18]** and I were firmly behind you in that effort. And if it's any consolation, the banks are in a very different ... today. And as I alluded to earlier, so thank you. But Michael, go ahead.

Mike Hansen: I'm with you 100% and I am sure it's not the right structure and it doesn't do what we want it to do. And as you're thinking about what we do from here, because it does need to change, is we have to go back and look at what is a Federal Home Loan Bank? It is not a private bank. It is not a private company. It is a quasi-public company, that's the best word I can come up with it. It's part stockholders, its part financial institution executives, but it has this broader public purpose. And so, the board has two competing organizational principles. In a quasi-public agency with a housing mandate, you need lots of voices and you need lots of people in the housing area. Not just affordable, I keep saying that, but affordable is probably the most important group. But housing policy, economics, a home builder, I think that's a great idea. People who are in that field, and you need lots of voices, but you also need financial institutions there who are putting the capital in and using the services. Now they're going to put the capital in because they want the services. The services are enormously valuable to the successful operation of the banking system, large and small. But they shouldn't be a majority of the board. All the financial institution executives should be no more, in my judgment, than 40% of the board. 60% of that board should be people ...

Mike Hansen: of the board, 60% of that board should be people who can be the counterweights to those types of issues about my institution. Now, those financial service executives, I know a lot of them in Boston, they're all good people. They have a fiduciary duty to their institutions. So, they don't want to reduce that dividend. And it's not just greed, it's doing their fiduciary duty. But that's why they can't be the majority. There has to be a broader voice. But now we have this need for lots of voices and participation and authority. That's why advisory committees don't work. And we also need the ability to have the financial institution executives heard, but not in control. So, a 50-person board, no, I'm joking. You're going to have a large board and that board has to be in control. But you have to run the institution with a management committee where the members rotate in and off. And maybe that's 10 people and they're actually doing the day-to-day management. But the big policy decisions should have this larger force. Is it messy? Yes. Does it take a lot of time to get consensus? Yes. But I think that's the only way you're going to craft an organizational structure that can meet the public purpose of what this system is supposed to be. So, I do think it needs to be restructured dramatically.

Chris Bosland: So that is another aspect of the statute where I think that's, what you're recommending is 180 degrees from the current statute, which I think says, I'm looking at my council over there, who will correct the record if I misspeak, but it's the opposite. Where independent directors are at least 40, but no more than half.

Mike Hansen: Yes.

Chris Bosland: Or have to be less than half.

Mike Hansen: I'm flipping it in my proposal.

Chris Bosland: So, I mean, anyone else went weigh in on what the optimal sort of ratio or whether that's important?

Ed Golding: Well, I mean, yeah. Part of the question, even though they're not publicly traded companies, there are some principles of what you want a publicly traded company to be. And there's obviously a lot of centers, including up at Harvard Law School that just studies and writes about board governance. And one of the things, it's both about size, I think Steve talked about sort of optimal size. The other thing is not having staggered boards, having more of turnover and competition for the board members. So, sort of supposedly best practices, whether this translates into this structure, something I think you need to think about. But best practices on a public board would include standing for election each year, one-year terms, so that you could potentially have competition, other people putting themselves forward if they don't like the direction of the board. I don't know how, it's hard to really imagine that you can't have a hostile takeover the way you might, or there are plenty of activist investors who do provide discipline on the board. It's difficult to replicate that. One of the things I suggested is just sort of having the FHFA step up and just approve all public, the slates. Not necessarily electing them, but people who want to be nominated for the public interest members. And it could easily be more than half. Have them at least being aired by FHFA; you would have to publish regulations. It can't just be sitting there and saying, "I like this person, I don't like that." But you could impose sort of some, I think the regulator may need to provide some of that discipline that the markets or shareholders would otherwise provide. I don't know how you get that from the current structure.

Chris Bosland: And just to be clear, are you saying for the independent slash public interest directors or for the members as well?

Ed Golding: Yeah. Well, I was thinking for the independent ones, but you could do it. I mean, somebody, if you don't like the CEO of a community bank, some regulator already has that in their job description to make sure that people not there. The FBIC or the state regulator. The question is could you take a more active role in shaping the board? You could worry about diversity of talents and the like on that. Again, you'd have to do it through regulations and have clear criteria. But I do think FHFA may need to provide that sort of what I'll call market discipline.

Chris Bosland: So, Chris.

Chris Herbert: I'll be a little less wishy-washy than my first answer, which is I'll say that, you know, you asked me about the GSEs. I was thinking about what lessons from the GSEs, but I do think from the regulations for the federal home loan banks, having independent directors and having that group, which in my mind, the way I think of them, as folks who are more focused on the mission part is a plus. And the GSEs don't have that at present. And as a result, I think you can see that get lost on the boards of the GSEs. To Mike's point about what the right balance is, I'm wrestling with that. Because I think the challenge here is, and

Director Thompson has been clear on this, and so lot of her's tell the GSEs and tell the public is that we have two missions. We have a mission to promote affordability and we have a mission to absolutely promote safety and soundness. And in some sense, you have to have that representative on the board as well. And at the risk of being too simplistic, we might think of the member directors as focused on safety and soundness and the independent directors focus on mission. And so, in some sense of the question is what's the right balance between those two? And obviously, you want every director to have all those things forefront of mind because that's every director's responsibility. But in some sense, where you come from, where you sit is where you stand. So, I'm not sure, Mike. I mean, in some ways that leads me almost to a 50/50 split as opposed to a majority. Because I do feel like having folks who are focused on the business of the banks is critically important. But you don't want to have the mission voice be too small. So, I think we're kind of, again, we're close.

Mike Hansen: Exactly. One thing I may have mentioned is I don't think the independent directors should be elected by the members who put the capital in. Because it's not a regular bank. So, it doesn't do us any good if the independent directors are in fact a subset elected by the same members that are electing the financial service. I'm really looking for true independence. Now, if we can get that, 50/50 is great. I mean, I think, I'm not adverse to that, but right now the independent directors are in fact still dominated by the members who are electing them. And you're really not getting, I think, enough divergent views to get a better public policy result. So, some are going to be, maybe independent directors are appointed. I think the regulators should have a role in that. I don't know how we're going to figure out how to select them, but I think this election is dominated by financial institution executives, including my members. I don't think the whole board being dominated by that process gives us that diversity that we really need.

Chris Bosland: I understand that. Those of us who lived through the finance board's attempts at appointing the directors in the past, you can see the records in 2003, 2004. It was not, covered itself in glory in those days. But Eric had a question.

Eric Howard: Yeah, I just wanted to get your thoughts. We've been talking about more voices. What about the voices of member directors? I mean, should there be a director, a member director for community banks? Should there be one for CDFIs? Should there be one for credit unions, insurance companies? I mean, is the diversity of member voice, is that something you have a thought on?

Mike Hansen: I actually put that in my outline. I think that those categories are very different. Big bank, commercial bank, community savings bank, credit unions, insurance companies, I think they all should have at least a voice on that board. But within that institutional half, if we will. I think that would create more diversity in the decision making and better decision making as a result if you had that.

Eric Howard: So that would be a regulatory requirement?

Mike Hansen: I think all of this requires statutory requirements.

Eric Howard: OK.

Mike Hansen: I think, at this point, given my understanding, I don't know what the way you do, but the statute's going to have to be changed, but I thought that was part of the exercise. So, what we want to see at the end.

Eric Howard: Right.

Chris Bosland: So, Mike, let me just picking up on something that Chris said about the safety and soundness focus. I mean, I hate to put you in the hat of the member, we had, unfortunately, some of the other panelists were representing members. But since you're the member person here today, I mean, do you have a sense of, I mean, you're obviously advocating for a 50 or more split for independent directors under your definition of independence. But how do you assess from what you can see, and I hate to make this about the Boston Bank.

Mike Hansen: That's OK.

Chris Bosland: But I think it'll inevitably be about the Boston Bank, but the board's focus. I mean, how is it split between safety and soundness and mission? Or is that a false split or how is that?

Mike Hansen: Let me talk about the Boston Bank. Great boards over the years, great people. I've known them. Great bankers. Good people doing a good job. But I think as Chris said, your view is where you sit. I might have gotten that wrong.

Chris Herbert: Where you sit is where you stand.

Mike Hansen: Where you sit is where you stand. And I think institutionally, all of these types of quasi-public organizations that have this broader mission, they do better with more voices in control. In other words, the 50% has to have real authority. That's why the board gets too big, and you have to manage it with a smaller group on a day-to-day. But yeah, I think that these are good people doing a good job, but I don't think we are meeting our housing goals as a society. And the Federal Home Loan Bank is part of that as well. And I think we can do better. And I think these organizational structures will allow us to have better safety and soundness, better voices, better mission creep. I think you said. We don't want mission creep. We want to make sure that the decisions that we're doing are more effective. And the way to do that is to bring in more diversity in the decision-making component of the board's structure.

Chris Bosland: Steve?

Steven Cross: Well, in my written comments, I recommended a 50/50 split. I do think that there needs to be a greater representation of independent directors. I don't know that I'm necessarily opposed to 60, but I did feel that. Secondly, I agree with Chris Bosland, that we don't want the FHFA to be appointing the independent, or I shouldn't say we.

Chris Bosland: Yeah, don't put that in my mouth. I was referring to an incident in the past. See the disclaimer that Eric nicely read.

Steven Cross: Anyway. But I like the notion that I think I heard from Ed, that you publish a request for nominations from the public. And as part of that nomination, we establish certain standards that must be met, including experience in one or more of these following categories. I think those categories could include what we normally attribute to member directors. There's no reason in my mind that you couldn't have an economist from MIT, who is very well versed in financial derivatives and interest rate risk management, stand as an independent director. The responsibility of each, it would be the responsibility of each bank to have a full set of competencies satisfied by the slate of members that they put up for election. As for the selection, I'm sort of still stuck on it. Probably has to be members electing the independent directors, but not the members nominating the independent directors. Those are my thoughts on those.

Chris Bosland: Interesting. Thank you. Engrossed in the conversation. I've colossally mismanaged time. We were supposed to talk about the independent directors before the break, but we're going to probably push that to after the break and we'll talk more about that and perhaps the nomination process. But before we leave, I forget who mentioned it earlier, but it was certainly in the written materials that several of you, the state focus of the election of the member directors, is that still appropriate? Is that desirable? Whether it's the grandfather provision or otherwise. I think someone had recommended at large sort of voting or district voting for all directors, but maybe I mischaracterized that. So, Ed, was that?

Ed Golding: Yeah, I mean, I still go back more than one board. So, it's good to have a derivatives expert from MIT on the board, but you're not going to find 12 of them or 11. So again, some of this question is how many boards are we talking about here? So, I'll go back to the pitch for one board if we're starting with a blank slate on that. At that point, and I think Steve summarized it, there's a role for FHFA to sort of be the first level of review and make sure that enough representation is being put in front of the members. I think at the end of the day, it has to be member voting. I don't know how else you, it is a sort of a mutual type of organization. There's no doubt. The question is how much FHFA does, it has enough power to get outcomes if things look like they're going off the rails. You do have a lot of authority, as you know, to shape the future of these organizations. But I would think, I would break down the states. I would just have everyone, and I would break down the residency requirement. If you want someone from, University of Cincinnati has a very good business school, I put a lot of pitches in for Cincinnati here. I'm not paid by them anymore. But there's no reason why Boston can't have a derivatives expert from the University of Cincinnati on its board. I think I'd break down a little bit of that regionalism that was very prevalent in 1932. Doesn't seem to be as useful now. And the members still get, if we have the 11 banks, it's still voting by the members of that bank. But I don't think we should have restrictions based on states.

Chris Bosland: Mike, any reaction to that?

Mike Hansen: So, I mean, Chris mentioned regions. I mean, my concept is that it doesn't have to be the geographic states, but mortgage markets are different. And they're very different between various regions, but Northern New England's very similar. So, I mean that you could still do some kind of regions in the various districts that would accommodate that. And in terms of the independent directors, there's no reason that it has to be members that elect the directors. You can have appointments, even though that's not an easy thing. You can have appointments by the board. The board can appoint a slate. The other players and the independent directors can appoint or nominate other independent directors as vacancies come out. So, there's ways of doing this that you'd never do it in a normal publicly traded company, but that's not what this is. So, there are some other ways where the independent directors can be truly independent and can perhaps self-select their future once the first grouping gets put in. Novel, but the whole Federal Home Loan Bank System is novel. I mean, there's not much out there like this. And so, I think there's ways we can do it. I wouldn't jump to member voting because then I think you're not going to get the diversity that I think we are all talking about getting on the independent side.

Chris Herbert: Just, I guess my two cents, I think, going back to the question of the ideal board size, I mean, I think Steve's right. I think, my experience is 12 to 14 members, other than that, it gets to be unwieldy. It's hard to know your board members. You need to have a collegiality there to work together. And if you're then at that scale, having quotas by state, having quotas by category of members gets awkward. And so, it seems like you could have a mandate that says that collectively the board should represent the interests of the different member institutions and the different geographies without having to be so specific as the state. And as Mike said, I mean, I think there's nothing necessarily magic about Vermont versus New Hampshire versus Maine per se. I mean, you may know better Mike, given differences in state regulation. But it would seem to me that having a mandate say that the board collectively should represent the interest of the geography without getting so quota driven would be best.

Mike Hansen: This just dawned to me, maybe we flip it. Maybe the advisory board becomes the state representatives and not the board itself. There's other ways of getting those voices into the corporate C-suite without necessarily linking it to a seat.

Chris Herbert: Right.

Mike Hansen: But I think the concept of geographic representation over the housing market is still important in some way.

Chris Herbert: And I don't know the function of these advisory boards well, but it seems to me that you do have those as entities. They know the bank; they know the bank's business. I don't know if there's a role for them in terms of preparing a slate, say of independent directors. I mean, that might be a group that knows the business well enough and thinks about across the kind of spectrum of what you want to have represented, that maybe there's a role for these advisory councils in terms of proposing a slate. If you want to still have members vote on them as opposed to them determining the slate, you have these other groups help develop that slate.

Chris Bosland: OK. With that as a teaser. We'll come back to that after the break. Let's take a 20-minute break. So, it's 2:21, so we'll be back at 2:41. Thanks.

Eric Howard: Welcome back to the Federal Home Loan Bank System at 100 Roundtable on corporate governance and the system structure. So, I think when we left off, we had been talking about member directors. I think one of the things that's been challenging for me is we're kind of talking about several different topics. I have them all orderly on my page. So, we talked about member directors. But let's dive a little bit more into independent directors if we can. So, we can take this wherever you want. But I thought we would start with what is independence. And we've been touching on that a little bit about how independent directors are nominated; independent directors are elected. I was wondering if any of you had any comments on that.

Mike Hansen: Well, I'll jump in.

Eric Howard: Great.

Mike Hansen: I think.

Speaker 1: Microphone.

Mike Hansen: I think we have to change the independent director's structure that is being used now. And I think we have to find a nomination or election process that creates a divergence between the financial institution CEOs and directors and the independent directors. And I think at the end, the goal, as I mentioned earlier, is to get as many additional voices as possible into the decision making of the organization because I think we'll get better decision making. I think you'll get better safety and soundness decisions. And I think everyone will be enriched by that kind of diversity. Now, how you do that, I do believe it has to be a separate system than the election system because if it’s just an election system by members, the financial institutions will dominate that process. And just natural human behavior, it'll be people they know and are comfortable with, and we might not get the housing diversity. Now, how we do that, I think it's an art, not a science. And I think we're going to have to think some creative ways of doing it. Whether it's appointed, as we mentioned before, whether that group becomes self-selecting. Maybe the group as a whole is self-selecting. But I think you definitely need directors that are unaffiliated with the decision making at the financial institutions.

Eric Howard: OK.

Mike Hansen: Hopefully, I dodged your question sufficiently on how to do it, because I really have no idea.

Eric Howard: No. OK. Well, does anybody have any thoughts on how to do it?

Steven Cross: Well, we talked about this a little bit. I do think that there should be a process that has been vetted through notice and comment.

Eric Howard: OK.

Steven Cross: Whereby people are nominated as independent directors from outside the system. And I mean, want to be careful because as I told you earlier, some people have viewed me as arrogant in the past, and I don't want that. There are many great independent directors now.

Eric Howard: Yes.

Steven Cross: And I look at the board, there are many great independent directors. So, anything that I'm saying is not intended to impugn qualifications of existing independent directors. But I agree with Michael, that having the process come out of election through the members, sometimes nominations through members, I think is problematic in terms of having a true in independence. I also question whether or not, in looking at independent directors, whether we, I don't know quite how to characterize this, but one of the stakeholders in the system is the taxpayer. And how is their interest represented on the boards? As someone who is sort of independently thinking in terms of the role. All of this comes back to the role of the home loan banks to me. And who's actually asking, "So how many federal funds have you sold in the past month? And what percentage of federal funds supply is coming out of the federal home loan banks? And how does that advance the mission-critical interests of the Federal Home Loan Banks? And is your maturity of your consolidated obligations lengthening or shortening? And if it's shortening, how is it matched against your advanced business?" There's all kinds of questions that I'll tell you, I can't figure out exactly what's going on, but I have a feeling that the Federal

Home Loan Banks are engaged in a lot of lending that sort of falls outside of the simple advances to support housing finance business. And I want to see some independent directors that are asking about why are you doing this? And I think that that takes you away from the members nominating these folks. Now, I know that some of the banks, maybe all of them, have advisory committees that may also be part of this process. And that may work fine. But I really like the idea of having an opportunity for members of the public to raise their hand and say, "Here are the qualifications I have," or "This person has to fill this role." And as I think has been said before, I don't think it has to be limited to people within the confine. I mean, to me, it's crazy that it has to be limited to the geographical confines of a particular institution. Now, how they are selected, how they're actually then appointed, I'm with Michael, I have to punt on that. I said before that if that process of nomination was sufficiently independent and there were controls on it to ensure that the skill sets are appropriate, then electing it from the members, I can abide by that. I'm a little bit less troubled than Michael, but I understand his point. And I just don't know how else to do it because I don't want really to want the regulator to be appointing the board members. I think approving a slate is OK. I'd also like to see in both the independent and member directors, slates that are larger than the number of positions to be filled. There's a lot of, I've heard a lot of people say, "Gee, we don't want to ask people to run and then be turned down." But I mean, we're all big boys or big girls here, and I think that should be part of the process, that there should actually be some choices.

Chris Bosland: Well, that brings up another related issue, either under your proffered sort of notice and comment approved process, but also under the current process, what's the role of transparency here? And do you think that the process is currently transparent enough? Meaning do people know, for example, that there were two slots and two people nominated and two people were elected? Oh, gee, was the saying. I mean, is there a role for greater transparency here? I don't know, I'm not, I've never voted in one of these elections. I don't really know.

Mike Hansen: So, the problem with it being an election is that the financial institutions dominate the number of votes cast. And again, I'm with Steve, these are people I've known most of my career. They're good people, and we have some great, and this isn't an aspersion on anybody. But just by the nature of that, the people who will be elected in that environment will reflect the relationships and the interests of the people who hold the votes, as just the way it works. And I don't think there's any way around that if it's an election process. I can't think of one.

But I do think the independent directors, depending upon how we define that, I do think the independent directors have to be selected in a way that is separate from the member directors. And I think they have different interests. Whether it's an advisory board that nominates them, the regulator signs off on them, and then there's an election by the advisory group, there's an election by non-bank. I think you're going to need two election processes or two selection processes in order to maintain some balance of independence. Just as a practical political matter, I think.

Eric Howard: Yeah. I have a bit of a problem with you. Are you looking at my notes? **[inaudible 01:31:54]**

Mike Hansen: No, no. I don't have good enough vision to see your notes.

Eric Howard: Steve touched on a number of issues, and you just touched on it too, but I thought, Chris, in your comments, you talked about the role of the Affordable Housing Advisory Committee and their potential role. I mean, they review the nominations. But do you have more specificity? Do you have more thoughts on how the AHACs could be used to facilitate this process? I mean, are they truly independent? I mean, they're not members, so if you could expand on, and anyone else that might want to.

Chris Herbert: I'm not intimate enough with the process.

Speaker 1: Microphone.

Chris Herbert: Sorry. I'm not intimately familiar enough with the process to go into specifics. But I think that that group, to me, represents, it's intended to represent the community. And it by nature will be more diverse in its perspectives than the members will be. And so, it seems to me that we're looking to have more independence, reflecting the community and greater diversity.

Chris Herbert: ... Independence, reflecting the community and greater diversity. That if it's a choice between the members, who are the board of directors who are voting for this, and giving that group some more say, it seems to me like that that's a natural group that's already created that has that diversity, that has that interest, that has that expertise and familiarity. I don't really understand the process well enough to get into specifics, but I think Mike you talked about, both in your preview questions and earlier, the value of diversity of perspective. And if we look at the members, I scan through the boards of directors, they don't look particularly diverse. So, it does seem to me that this is really a way to get that diversity perspective, diversity of opinions and it's a resource that already exists that could be tapped to help with that process.

Mike Hansen: All of the research, and I'm sure you've all seen it, the more voices we get in the decision making, the better the decisions are. And it's going back 30 or 40 years in all of the research now, and the only way to get diversity is to go get it because financial services, and this isn't an aspersion on anybody, as an industry we really lag in diverse faces and diversity within our ranks. And whether that's gender or race or ethnicity or whatever, we have to go out and get the diversity and bring our industries along. And I think that's where we are right now. And I think we have to do that. And so, when I say diverse voices, I mean diversity in the sense that we talk about now in those issues, but also housing, construction, economics, asset liability management. We really need experts from different fields to participate in the decision making in a meaningful way. And I think we're going to have to go out and get it.

Eric Howard: You touched on my next question about the diversity of skills. Because the law identifies skills independent directors should have, are there other core competencies that you can think of that we should be focusing in on?

Mike Hansen: Well, I haven't had a chance to read the list in the law. I should have done that; I didn't think of that. But I think when you look at complicated financial institutions like this, there are a lot of competencies that are necessary for a board to render independent judgment. One of the things we talked about, I mean you look at Enron, I hate to go back that far. It had one of the best boards on paper you could imagine but they weren't doing the work, they weren't doing the job, they weren't asking the questions, they didn't have independent thought and we had a massive collapse. So, you need people who can provide collegial checks and balances over what management is saying regardless of the institution. So, you need an accountant, you need somebody who's going to be there. You need an asset liability specialist, you need a housing economist, you need somebody in affordable housing, you need someone in regular housing. So, you need this diversity of skills, and this is really complicated. So, there's a lot of folks you're going to need to be able to draw in, in a meaningful way. And that goes up against our concern about having a board that's too large and unwieldy, but we've got to find a balance to do that.

Eric Howard: Does anyone have any thoughts on board training? What the banks are doing. I mean, you talked about some hard skills, also some soft skills. Should this be mandated? I mean, is there any way that the agency should...

Mike Hansen: Yes. Training, training, training. As a group, however many banks we have, they should be being trained as a group with the regulators' involvement. They should be trained individually, and there has to be a high focus from a corporate perspective. Now, most of these companies are run pretty well and I think they probably do have a board training program, but board members have to get together on a regular basis. They have to break bread, they have to be trained, they have to learn skills that they don't have already, and they have to be very engaged in a collegial challenge of what management is providing and what the regulator is providing too. There's got to be that dynamic and it's got to be a job.

Ed Golding: We talked about FHFA creating standards through regulation, we've sort of talked a little bit about slates and in some sense, this is the hard work that has to be tailored towards the system. But just an idea, if you want more people with housing and community skills, maybe one of the requirements is they've served three years on one of the AHACs and then you get four people applying, but you have three of your seats. So, you come up with... members can still vote at the end. I at least haven't thought of a way of getting around that. But if one of the requirements is that they've been three years out of AHAC, at least you bring the diversity of that representation and sort of a career path. And it has to be written down, has to be thought through, has to be in regs. But you need to figure out, sort of what Mike described, how do you reach out to the broader community if there's clearly... what does it mean to be an outside... Sarbanes-Oxley talks about the requirements. I don't know if that's been adopted for your accounting skills, but there are plenty of ways of making sure you have good accounting skills on the board. I think you have to go through and figure out what makes for an acceptable slate that meets all these different criteria and then let the members vote. It may be that even though you don't want FHFA to do it, it's very possible that the screening process comes up with only one slate. But at least you've gone through a process that's transparent, that people who are interested in the system can speak up. And I think it's working through those details that will get you the diversity of skillsets that you need.

Chris Bosland: The banks, or at least most of them, assess the board needs, so to speak. So, Steve, under your idea of notice of solicitation for nominations, would that be part of it? I mean, would you envision the banks sort of identifying what they're looking for with some specificity perhaps along the lines of what Ed's saying if we've got to meet these criteria? And here's...

Steven Cross: Well, I think that we have a pretty good idea of the skillsets that should be represented on a board. Asset liability management, various forms of risk management, some familiarity with collateral policies and collateral evaluations and protections, legal accounting, a housing, affordable housing, and community development. I think maybe compliance, regulatory compliance. So, I mean, going back to an earlier comment by Ed, where the board is refreshed every year, you're making sure that the slate that's up has that. Now I think that in some way there has to be some transparency on "This person is up here because he or she has this set of skills and it's one or more of those listed skills" and the entire slate covers the full gamut. If, in fact, you have boards like today in which only part of the board rolls over every year, then I think the bank should be part of identifying what skills are absent at the present time and need to be included in this slate. But if you're really doing this in a transparent manner, that's already going to be known because you're going to know who has what skills and which ones are missing as you go forward.

Chris Herbert: Just a small point, but Eric you had started by asking the question of what are the list of skills needed? And the list that's in the notes for here, and Steve reflected them, are mostly financial management, audit accounting, rich management, practice derivatives, et cetera. You mentioned affordable housing, housing policy, community lending, small business lending. That's a set that's missing now, I think from the formal list. And so, I just think as you think about that criterion, we should make sure that those, kind of what I would describe as more mission side or business side, as opposed to risk management side are reflected. And just to echo what Steve said, you want those characteristics reflected across the board and not just a seat for this role and that role, and people may have different strengths that they bring to it. So hopefully you have a slate that reflects that as opposed to recruiting for a specific seat and that's my role. You want people to have broader perspective of their role than just that one perspective.

Mike Hansen: And the only thing I would add to that, I agree with that, is that I'm torn on the one-year election. I mean, it sounds very democratic, it sounds very good, but many times you could run into a political situation in which a board is destabilized politically in one year. And there are political battles that go on in these types of organizations. So historically, I've usually said three-year staggered terms so that a third of a board roll over every year gives you more stability, but it doesn't give you the democracy. So, there is a balance that needs to be there, but everybody being elected every year could result in some instability depending upon what happens. We have to be thinking about that.

Chris Bosland: And since, with respect to the member directors at least, I mean, it's very difficult to control that, there's no slate, well there is a slate, but the bank has to take the luck of the draw, so to speak, to some extent. So, are you advocating for this list of skills? I mean, should that be reflected within the independent directors or how do they take that into...?

Steven Cross: No, it's both. I think the member direct-... again, I'm starting from the premise that it's not just all driven by states and that even... Depending on whether we end up with separate election processes for member and independent directors, which is something we haven't resolved at the table but has been presented.

Chris Bosland: We have time.

Steven Cross: I think the same, the slate of nominees should be reflecting a certain set of skillsets. And I think in my written comments for the future, I identified certain sets that might be appropriate for member directors and a set for independent directors, some of which overlapped but some of which were different. And I don't think I included small business lending, but conceivably, depending on where you end up with what constitutes community development activity, that could be part of the list as well.

Ed Golding: I am not aware of what is currently done, but in private boards for publicly traded companies, there is a cottage industry of search firms that are not transparent but serve a role in the market of balancing some of these issues. So, as I said, it gives me pause because it's not as transparent and the like, but that is something to consider. And I'm not sure which banks may already do that, but that's another resource that publicly traded companies tend to use.

Eric Howard: So, we've been talking about member directors, independent directors. Let's talk about a subset of the independent directors, and that's the public interest directors.

And so, the Bank Act notes that at least two of a banks independent directors must be public interest directors who have at least four years of experience in representing consumer or community interests on banking services, credit needs, housing, or financial consumer protections. So, are the statutory qualifications required to serve as a public interest independent director rigorous enough to ensure true representation of consumer and community interests? So, I'll toss that one out. Does anybody want to jump on that? I have no takers.

Steven Cross: Well, get the ball rolling. I think that I would qualify as a public interest director, but I'm not sure that I think I should qualify as public interest director. I'll leave it at that. I mean, I've spent many years heading compliance policy at the control of the currency and the FDIC. In my advisory career, I've worked a lot on consumer protection matters, fair lending, CRA and other consumer protection laws and regulations. So, I think I fall into that category, so I think it should be probably more tailored and I think it should be more tailored towards the core mission of the home loan banks at its inception, which is financing housing. And if you want to make it at least one member, be representative of affordable housing, I think that would be appropriate as well. So long story short, I think it might be stated a little bit too broadly and I think that there needs to be some particular focus on affordable housing in support of the affordable housing program or the community development lending in initiatives of the home loan banks. But I'll stand corrected by my...

Eric Howard: Well Steve, that was one of my follow-up questions, is should someone with government service be excluded or should they be included? I mean, does anybody else have any view on that?

Steven Cross: Well, they shouldn't be excluded.

Chris Bosland: Yeah, I'm not sure.

Steven Cross: At least as independent directors.

Eric Howard: Okay. But as the public service?

Steven Cross: As far as public interest, again, I think that I find that definition as you read it, to be very broad. And my point that I fall into that category is only that representation, that that's a very broad definition. And I think that at a minimum, the agency needs to be thinking, "What is it that we want out of these public interest directors that's separate and apart from what we want generally from independent directors?" and only after asking that question can we say whether or not government service should or should not be sufficient to fall into the category.

Mike Hansen: I would just add, I would exclude currently elected officials. And I don't know that you have to do that, I think the conflicts of interest that would apply in that situation would probably push that category out anyway. But I would avoid bringing any political aspects into the board structure.

Eric Howard: So, what about moving a little further down the road, what about the difference between non-profit and for-profit? Like if you have an affordable housing developer, someone who works with a non-profit organization who has acquired this experience through non-profit experience, should it be limited to those individual individuals or for-profits that's open to them also?

Mike Hansen: I don't see any difference if the director is good and has a skillset and is going to do the job. Again, it depends on the specifics as to whether there's a conflict, but absent a conflict of interest, I don't see the difference. I would want both, frankly, if I could get them.

Chris Herbert: One thing that occurs to me is, it's hard to distinguish or to separate the written specificity of the language from the process. And I feel like if there's a process that is going to generate a good set of independent directors that are trying to achieve a certain goal, you don't need to have language that's too specific. If you don't trust the process, you're going to need that language to back it up. And as the language gets more and more specific, you can also create hamstrung people and they don't necessarily reflect changes in the environment. So, I would err towards the side of thinking about a process that's going to generate a slate that fits the goals of what we're trying to accomplish as opposed to honing the specific language.

Chris Bosland: Great.

Eric Howard: Well, I keep going for the specific, but...

Chris Herbert: Sorry, I didn't go to law school for a reason.

Steven Cross: I think I agree with Chris's point, and ultimately, I think it leaves you with the question, "If you have a robust and transparent approach to selecting independent directors, do you need to have a separate category within that of public interest directors?".

Eric Howard: We talk about at least two, are two enough? Should there be more than two? Should there be four? Does anybody have any views on that? Public interest directors.

Mike Hansen: **A**s long as the independent directors including public interest directors are a majority or a little bit more than a majority, depending upon what the number is, I don't know that we need specific numbers of it. Again, we've got all these wish lists, we're going to end up with a board of 30 people, and we have to be careful of that, although we need these skills, in my opinion.

Ed Golding: But I mean, in some sense, this discussion would lead you to having seven independent directors, six member directors with a board of thirteen. I mean, to put numbers and on what I'm hearing is, that would make for a good board. And then the question is, "Of those seven, how do you establish a process that you get the skillsets that you want?". Clearly even the six of the members should have... not every CEO or board member of these banks have the accounting or compliance skillsets or the collateral skillsets. Again, the art of putting together a board not easy. I talked about a search firm, not my preference, but can FHFA through a nominating process basically say this slate seems robust enough that it meets these general criteria that are in the law? That is, I think what you want, but it does put the onus on FHFA to set up a process.

Chris Bosland: Steve, earlier before the break, you were talking about, for lack of a better term and I apologize, the fiduciary duty, if you will, of the duties of a director, member or otherwise. How would we define that? Because I think under that idea, if it was clearer, whatever clear means, then some of this is sort of beside the point, not beside the point entirely, but I mean the concerns might be mitigated if there was a clearer duty. I mean, how would we go about expressing that?

Steven Cross: Well, I think that it's multi-pronged because I think it really goes to the fundamental question of "What is the appropriate role of the Federal Home Loan Bank?". And when I mentioned fiduciary duty, I was looking at it from the perspective of asking the members of the board to be asking themselves, "Is this bank operating safely and soundly and in conformance with the appropriate role of a Federal Home Loan Bank, which is a government sponsored enterprise that is free of taxation, that has priority lean status and enjoys the benefits of the implicit or implied guarantee?". And so, to start with, I want to have boards where the directors are just asking questions about why are we doing this? Why are we supplying as much federal funds as we are? Are we issuing COs with the right maturity structure given our asset? Or are we engaged in some bets here? When I talk about fiduciary duties, I'm doing that. But that also fundamentally gets to whether or not the role of the home loan banks is to provide liquidity for short term needs or liquidity in support of housing or some other set of noble public interest goals.

Chris Bosland: Yeah. Okay, fair enough. What you're saying is clarity of the mission would then... and an obligation to address that, whatever the mission. I don't mean mission, the mission currently today, but mission broadly defined, whether that's liquidity provision or housing or whatever. Then if that was clear, then we could have directors sort of more accountable, would be more focused on achieving those ends.

Steven Cross: Well, that's what I'm saying. Yes.

Eric Howard: Okay. I want to talk about diversity on the boards. We've got diversity of thought, we've got diversity of skills but let's talk about gender, race, ethnicity. So, are the Federal Home Loan Banks doing enough to bring diversity onto their boards? If so, what are they doing? And if not, what should they be doing? And I keep staring right at you.

Chris Bosland: He was anticipating that. Yeah,

Mike Hansen: I guess I'm the easy target here. No, I'm kidding.

Well, so I can't speak to what they're doing because I'm not on the board and I know them well enough to know the Bank of Boston's a really great organization. What I will speak to is the end result because, and I think all of us, including them, need to do more. And diversity is a lot of things. It is, of course, gender and race and ethnicity and where you live and...

Chris Bosland: Stability.

Mike Hansen: ... Socioeconomic, and affordable housing, regular housing. And we need to go out and make it happen. And diversity is also experienced. We talk about asset liability and all these other technical skills and accounting, that's diversity too. But I think we all have to do more to go out and make that happen. Because the end result is, we get better decisions. You just do. I mean, it's a famous case, the Cuban Missile Crisis, you get better decisions when you have more folks in the role, and we all have to go out and make that happen. There's no easy way around it.

Ed Golding: Can I ask a question?

Eric Howard: Absolutely.

Ed Golding: Is there a disclosure today based on any of these categories?

Eric Golding: Yes, in the Office of Minority and Women in Inclusion Reports. The banks are required to report on the diversity of their boards. Okay. So, you're saying you're reporting on that.

Ed Golding: So, there's at least reporting. Okay.

Mike Hansen: And what's the number? Where are we?

Eric Howard: I don't have that in front of me.

Mike Hansen: I don't either, so. But I think we have to do more. I think it has to be a not nice to have, it has to be an affirmative part of our effort to create a more effective board.

Chris Herbert: So, what would reflect the diversity of members, right? Part of this has to do with the diversity of members as well. And part of the challenge here is that you're relying on the bank members themselves to be diverse, to be able to produce a diverse slate. And then the independent directors obviously provide an opportunity to go beyond that. So, it actually has to be a goal of the organization, the banks themselves, to be able to develop the diversity that then can be drawn upon for the board. But it certainly has to be a factor. I think the independent directors are going to play an important role in providing the diversity to the extent it doesn't exist in the banks themselves.

Ed Golding: And the members do not have to be the CEO, they can be any officer of the community bank. Is that correct? Is that...

Eric Howard: Yes, and board members too.

Ed Golding: And board members. Okay.

Eric Howard: Yeah, over the institutions.

I think that's been a challenge for the bank. It's not the most diverse group of individuals to select from. Going to push this a little further, do you have any recommendations on what the banks can do to influence the nominations for member directors?

Ed Golding: Well, you could get more CDFIs as members, justices.

Eric Howard: That's a good idea.

Ed Golding: One way, I mean, it would help... The question is, "What are the 10 things that you can do today that would help?" and if every Federal Home Loan Bank helped sponsor two more CDFIs and we had one CDFI on each board, it would be a different makeup very quickly. In 1950s it was fine to talk about pipelines, it's time to stop talking like that and just doing it and figuring out what are the ten things you could do differently tomorrow. Because I don't think it's a pipeline question.

Eric Howard: I agree.

Chris Bosland: Anyone else on this issue?

Eric Howard: No, I think it's great suggestion.

Chris Bosland: Okay. You [inaudible 02:03:00] good.

Eric Howard: Oh, sorry. Just enjoying the conversation. Let's pivot to everybody's favorite topic.

Ed Golding: The Cincinnati Reds?

Chris Bosland: Executive and director compensation and how that plays into governance and what we're talking about. Obviously, the statute gives... the finance agency puts us in a little bit of a strange position where we have to approve compensation arrangements for the top executives, but we're not allowed to set a range. So, it's kind of a strange little quirk of the law. But obviously compensation can be an incentive to get different skillsets that may not be there. If you're talking derivative expertise, maybe that's a different price point in the marketplace. So, should there be limits or restrictions on the compensation executives and director's receipt at a Home Loan Bank? Ed?

Ed Golding: Well, I'm still going back to one bank, so it's an easier question...

Chris Bosland: On the executive.

Ed Golding: Well, no, I mean with one bank, it just strikes me as very wasteful to have 12 banks and 12 relatively expensive folks. And this is... So again, part of it... Yeah. So, the answer... Yeah. So, it is partly... It seems like you should be controlling... if these are community banks that you're serving on a very relatively simple business model, that you should be asking yourself "Are these compensations appropriate?" And I think it's part of the public purpose. The Federal Reserve operates on a much lower pay scale and does asset... and has a 9 trillion portfolio that it manages. It can print money too, so it's an advantage. But I do think you have to look at things like the Federal Reserve system and ask, "Why is this so different than in terms of compensation?"

Chris Bosland: If we limited it to Federal Reserve scale compensation, I mean, does that inhibit the bank's ability to recruit the kind of people that you seem to be talking about need to serve on the banks, notwithstanding that it's a simple...

Ed Golding: Are you talking about the board or the management? I mean this is...

Chris Bosland: Well, a little bit of both, but let's start with the board. Then, we're going to get to management in a bit.

Ed Golding: And again, this is just perusing a few statements. The board doesn't seem to be that out of line on that, but I'll defer it to others.

Steven Cross: Well, the last data I saw suggested the median chairman of the board was getting about 140,000 plus certain expenses. And board members were about 108,000. And committee chairs were somewhere in between. And I don't know that I see that as being problematic at the board level. I think the issue is at the executive management level. And partly, it goes to the... All of these things come back to, what do the banks do? I think the banks are engaged in a lot of activities now that may warrant higher salaries. But should they be? And in its core function, lending advances heavily collateralized by mortgages to support housing finance, that's a pretty straightforward business that probably doesn't require a million-dollar salary for 12 presidents. But again, that's sort of said in a general term. I'm not questioning whether any individual is worth the salary he or she may be getting. So, if you step back from the particulars and ask, "What should the home loan banks be doing?" And the reason I keep coming back to that is they are government sponsored enterprises. There is the implicit guarantee. There is the super lean. And I believe that the function of the home loan banks should be narrower than it has been. And in that narrow realm, you don't have to compete with commercial banks for the talent. And I'll stop there.

Eric Howard: I guess I'll offer a few thoughts. I mean, one is that you certainly want them to have access to the talent they need to be able to run their business safely, soundly, and effectively. If you get into narrowly defining what those levels are, you can cut off the enterprises from getting the talent they need. What I would think about was whether or not the system as constructed is going to create an incentive to overpay people. It seems like the fact that these are member owned cooperatives, there would be some incentive to not have your profits absorbed by the staff. I don't know, in practice, whether or not that's true. I guess there may be some evidence suggested that the folks are overcompensated, that perhaps it's not working. So, I guess that's where I would start with that. To what extent do we believe that current system is overcompensating folks? And is there some information relative to what the comparable set of organizations are in the financial services realm? And how are senior executives paid relative to the distribution of salaries in that space? Are they overly compensated or not? And then, think about what kind of incentive structure is needed to bring them more in line. But you do get in trouble if you set sort of absolute limits on salaries when you're trying to recruit talent. And I don't know. The Federal Reserve is a public entity. And so, it's different in the sense that this is a private for-profit entity.

Ed Golding: Well, the Federal Reserve banks are

Eric Howard: Private.

Ed Golding: Private. I mean, I think they would say they are. I mean, they have shareholders. They have a board. They're boards elected by JP Morgan votes on...

Eric Howard: So, how do they get away with paying much less? I don't know if the record could read your eyebrows.

Ed Golding: Its markets are a mysterious thing. What do you mean by get away with? The Harvard professor doesn't... What's the top Harvard professor get paid? They said Harvard seems to be doing okay.

Eric Howard: I don't know, but I think they actually get paid pretty well.

Ed Golding: Not as well as the federal.

Mike Hansen:

I might as well light the room on fire. So, I do not believe we view these correctly. I don't think these are regular banks owned by bankers who put capital in. As part of it, this is a quasi-public agency, a GSE that has a great amount of government taxpayer subsidy, not direct. But, I mean, I think that's what we're all talking about. So, two things. One, I think for the executives you want to have... As a broad construct, they need to be able to recruit the talent for the complexity of the banks as they are and as they're going to be. And we can't have this conversation with any specificity when we haven't decided what the role is, but let's assume the role is as it is now, and they broadly support the housing market through the financial system, and they do what they're doing now. You have to allow the institutions, however many there are, to compete for talent. These are complicated organizations. If you read the Turellos white paper and you start talking about some of the asset liability things that he's talking about, which is really a good thing for you as the regulator to be thinking about, these are really complicated things. So, you wouldn't want to limit the ability to attract talent. Whatever that number is, I can't speak to it. So, on executives, I would give a free hand. On directors, I would say, we would do well if we could convert the view of these directors to more of an honor and a public service as opposed to a paid position, because it's a mindset as much as it is a number. And I don't think that's the position we have now. I think a good board could be attracted at a much lower compensation level because we got to change the reason, they're doing it. They're doing it as service to the industry, service to the country, service to the housing market. And I think the compensation for directors should be, by the institutions, brought back to a more reasonable level in my opinion. But don't restrict the ability to attract talent at the executive level. One of the problems... And this is not a problem and it's not a criticism, but when you pay well below the market, you get what is an institutional career path. And the Federal Reserve does this really well, but it is an institutional career path. It is a regulatory career path, and it should be. Given what the Fed does, we kind of want these federal banks to be part of that fed process. And they do an extremely good job. But I'm not sure that's what we want in the federal home loan bank system. I think we need more of a market driven system in the executive level to get the kind of performance we want. That doesn't mean they need to go out and compete for JP Morgan, and then Jamie Diamond, and all these... We're not at that level, but I do think a purely capped bureaucracy kind of pay scale will result in a different group of people running this. And we might not get the innovation that we really want to see in the housing market from these banks. Because I think your sensing, if I sense correctly, is we all think we need to do more about housing, affordable housing being part of it, but we need to do more and we need to really have these banks be innovative, and well run, and safe and sound, and good asset liability. You can't do that when you restrict the compensation too far.

Ed Golding: So, first of all, I'm not sure what innovation means here, so we'll come back to that, but I would argue it's not... If it is complex, it goes back a little bit to what Steve says. It shouldn't be complex. There should be a fairly simple business model to run. Whenever these issues come up in Washington, they point out that NASA truly has rocket scientists who really did put people on the moon. I don't know how complicated that was, but they managed to do it under the federal pay scale. So, they do have rocket scientists there. I'm not sure why this is so complicated. I mean, I understand black shoals and option theory. You can get that from a calculator now. And I would imagine most of the CEOs of the federal home loan banks couldn't derive black shoals either or should they on that. But it's just not... Cultures grow up to... Pay sort of grows up within the culture and people don't want to challenge it. And I think the question here is, should it be challenged? And I think the answer is yes. I also would point out I don't think it's a huge issue, relative. I mean, you could add up all the costs. I think the operating costs of the whole system is like 1.5 billion. I think, if you went to one, you could probably cut that by a third. Probably, the amount of savings by capping executive comp is much smaller than that. So, in some sense, it's. Outside of a political issue, from an economics, it's probably not that big. But I would go back, and Steve has worded this well, it has to do with the mission. This is not complicated. The management should be able to ask, "Is our duration zero? Are we taking any interest rate risk? And if we are, why are we taking interest rate risk?" So, I mean, those are the types of questions... And by the way, you do have a regulator right here too who are asking these types of questions and who are addressing that. So, it's not like you don't have other layers of protection. So, I don't really think it's that complicated. It shouldn't be that complicated. And I think, even today, I don't see a lot of innovation. Maybe I'm missing it. I go back to where we started. It's a very important role. It provides liquidity to community banks. It has the ability to take collateral the capital markets won't take. It has the super lean that also protects it. For a very localized community bank that is dependent on the deposit base of that town in northern Maine, this is a great supplement. And that's what it was designed for. Fancy derivatives, callable advances, might make Wells happy to part those products. I don't think that's a product that community bank in Maine really needs.

Chris Bosland: Anything on this side. Have the flames kind of petered out over here? I don't know. I don't know. Steve, you want to take the bait. You already spoke to this.

Steven Cross: I agree with Ed because he agreed with me.

Chris Bosland: Kumbaya. No, no. Go ahead. Well, Eric?

Eric Howard: Sure. So, we've asked the four of you a lot of questions and we really appreciate all the input, the responses, the willingness to participate in this. I'm going to toss it back. Is there something we didn't talk about that you would like to talk about? I mean, it doesn't necessarily have to be about structure or governance, but if it is, that's great. But I just want to give you that opportunity before... This is the last round table, in-person round table. So, if there's something that we haven't talked about...

Ed Golding: Can I... I'll defer to others. But, I mean, one thing that... I think Mike sort of alluded to it, but one of the questions is what happened over the weekend. The financial institutions that collapsed all had large federal home loan bank advances. And I think that's an issue that people are asking about. You could take two sides. You could say it was a good thing because they would've had problems earlier but for the federal home loan banks, and that federal home loan banks sort of stabilized the system. I think that's where Michael sort of was coming from. There, I think, is a view that I'm willing to bet, if you wandered through the halls of the Federal Reserve, was the existence of the federal home loan banks that are not connected to the regulatory fed system actually made it a worse problem, that it would've been better if the Fed had been in there earlier, that if they had used the discount window that an acquirer could have been found in September instead of worrying about what happened on Friday. And I think that's an issue that I don't have the answer to. But I think, as you think through the role of the federal home loan banks, and I'm sure you're doing this, there are a lot of people in Washington who have been dealing with these issues that you sort of need their input on is, "Does the Fed view this source of liquidity as a good thing or a bad thing?" And that's their... It's for the Fed and for treasurer to answer that question. So, I imagine you probably have had those conversations, but I think that's an important part of this discussion.

Chris Bosland: Yeah. And that's obviously something that will be discussed to great length and examined going forward. The facts are a little different in each case, but the issue is there. So...

Mike Hansen: Well just for purposes of discussion, I don't think the Fed and the FDIC should answer that question. I think they should be part of it. But I think the Federal Home Loan bank system, the GSEs, all of the federal regulatory agencies ought to be looking at that because, when Silicon Valley Bank failed, 6% of its assets were in Federal Home Loan Bank. 6% is not sufficient to create the kind of disruption in the operation of that bank that the FDIC frequently says. The emergency liquidity aspect of that is extremely important in the world we live in now, because Silicon Valley Bank, as of Wednesday, was a well-capitalized, well-run bank. And there was no reason for the regulators to go in. They got caught. We got caught. Everybody got caught. This is what happens in the modern era. Deposits are incredibly volatile. And when you have a bank like Silver Gate, Signature, Silicon Valley, they have a narrow book of business in a tight industry with enormous amounts of uninsured deposits because that's... You're a high-tech startup. You raise $30 million. You put it all in Silicon Valley Bank. 250,000 of that is insured, the other 40 million is uninsured. 80 or 90% was uninsured. They had an unstable business model in a world that's now digital. And these tightly knit people got scared on Wednesday. And by Friday, it was insolvent. And that's the world we live in. In that world, where deposits are so volatile, the banking system as a whole needs resources and liquidity, because it actually helps institutions avoid failure when they have this access to short term money for whatever purposes they need for liquidity. All bank failures, 95% of bank failures, at the end of the day, are caused from a liquidity run, whatever the source of that was. Having a safe sound secure system to add liquidity, of which the federal home loan banks are one part of it, really does avoid more problems than you see. And unfortunately, there, we've got three big ones. And we have an environment in which people are trying to figure out what went wrong and who's at fault. But my view, from my experience, is the source of that liquidity is an amazingly important tool for the whole system to avoid these types of traumas. Now, the FDIC didn't like it because that 6% of assets will go out first in the receivership, because the federal home loan banks are fully secured. But if they weren't fully secured, then they wouldn't be able to get access to the reasonably priced funds that they then use in this process. So, I think it's a good thing as long as it's not overburdened. And I think you mentioned a bank that had 80... One of the federal home loan banks had 80% of their draws in one institution. That's a regulatory problem. That's a concentration risk. That needs to be dealt with. But that doesn't mean we need to get rid of that system. I think the system works, by and large. A little bit different view, but...

Ed Golding: Yeah. I was just saying it's an important... well plus, the FDIC more the Fed. That institution, ultimately, it's congressional decision. But you do have... The Fed thinks of itself as the ultimate provision of... is the ultimate provision of liquidity in the system...

Mike Hansen: It is. Yeah.

Ed Golding: ... on that. And so, the question is, do you want these two... Where are the frictions? Where can they work together? And I think getting them to work together, I think, will be important.

Mike Hansen: Agreed.

Steven Cross: Yeah. Well, I wonder... and this is just a question, whether the existence of the home loan bank advance allows or hides from the regulator what might be a pending problem and just kicks the can down the road. That's my concern about that. And Eric, in terms of your question, one issue we haven't discussed, it was not on the agenda for today, but just to throw it out there, is the issue of holding companies with memberships in multiple banks, and what implications that has for competition among the banks for the business of those members that are affiliated, and whether that's a good thing. Should an organization be able to be members of multiple home loan banks? My answer to that would be no, but that's the question.

Chris Bosland: I think Ed has a solution question.

Ed Golding: No, I was going to add... I was just...

Chris Bosland: With one bank, I'm just saying...

Ed Golding: Oh, one. With me, that would be a solution. The other issue, that most mortgage finance now is done through independent mortgage banks, the cash flows coming off of servicing is a very... I don't know if I'd say it's complicated, but there are very few people who really can figure out all the cash flows on every prepayment and every foreclosure. But there is a question that you grappled with, but I think people need to grapple with it again, is given that most mortgage lending's done by independent mortgage banks, do they need liquidity in times of crisis?

Now, they can get that indirectly through Freddie and Fannie. And Ginny can be that source. And that might be the answer. There are ways that those GSEs could do it, but there is the question of, does the Federal Home loan bank have a role to play?

Eric Howard: Anything else anyone want to bring up? World peace? Okay. Okay. So, something that we often do at these round tables is we do a little bit of a round-robin just at the very end. And so, what's the single most important change that you would recommend statutorily, regulatorily, with respect to the structure or the governance? So...

Chris Bosland: Assume we can only do one thing.

Eric Howard: Right.

Chris Bosland: That's a... One thing. I will say that, at past round tables, people just agree with the prior person, then add their own, because that was... If you got last, you gave more. But we're just trying to prioritize.

Ed Golding: So, I mean I would go to this... Whether this is one or two, I'll leave to you to decide, but...

Chris Bosland: 27 [inaudible 02:28:34].

Ed Golding: One bank, no bigger than 50-billion-dollar members.

Mike Hansen: Well, I'm not going to agree to that. I think I made that clear, although it's a good idea. I would change... I would take... I think the system needs to change its culture. And I would take the word affordable out of housing. This needs to be a housing organization of which affordable is probably the biggest and most important part of it. But we need to get back to the core principle of what they're doing. And that is providing financing and housing services so that we can do a better job of ending up with the right housing policy for our country. And I think it needs to become the focus. And the board re-composition will help us change that culture, get away from bank financing as our primary goal. I think it's our primary tool, but that's not the goal. How is that for seven things in one?

Chris Bosland: Well done.

Eric Howard: It's pretty good. Chris.

Chris Herbert: This is all a game of how you can take something complex and make it into one thing. So, I think, in some ways, the fundamental job is to define clearly the mission of the federal home loan banks. And I think liquidity is clearly the origin of the system. But I think what we're wrestling with, in terms of the public purpose beyond that liquidity, is how do we define that mission? And Mike, you've defined it clearly as housing, not affordable housing, but housing. I think that that needs to be really wrestled to the ground. Obviously, as a Houser, I think housing is really important. The financial system needs to support it. I think, in this case, it's broader. And I think, once we define that mission, we then have to make sure that the governance structure is supportive of that mission, which is liquidity, and it's affordable housing, it's community development. It's all the things that community banks need to support. And so, defining that mission and making the governance structure align with that to make sure that the individual banks are being directed, or an individual bank is being directed with that mission at Central is important. Did I...

Chris Bosland: Well done.

Eric Howard: That's great.

Steven Cross: Well, I think mine is broadly consistent with Chris's. I think that we need to define the appropriate role of the federal home loan banks. I'll go beyond what Chris said, and that would be that it should return more to its roots in providing liquidity and support of housing finance, rather than short term member needs, liquidity needs.

Chris Bosland: All right. Well great. All we have to do is solve mission and culture... No, no, this has been great. I really appreciate the discussion we've had. It's a fitting capstone to the in-person meetings. We have three. It would be remiss not to mention that we have some upcoming virtual round tables, I think, Maybe this week?

Eric Howard: This week.

Chris Bosland: This week. So, they'll be streamed only, dealing with access to the system and issues unique to the largely... not the 48 states, so Alaska, Hawaii, and territorial issues. So, we had one last week with Puerto Rico, but we'll be doing several more of those.

Eric Howard: But Thursday, it's Guam and nor Northern Marianas. And then, after that, I believe it's American Samoa and Alaska. And...

Chris Bosland: See, once you start naming them...

Eric Howard: I know.

Chris Bosland: ... you're at risk of forgetting.

Chris Herbert: I would suggest, next time...

Chris Bosland: [inaudible 02:32:22] about Hawaii and Alaska.

Chris Herbert: Let's do those in person next time and let's come back.

Chris Bosland: We do have an inspector general, so we got to watch out for that. No, but this is... Again, I want to thank you for your thoughts today and the comments that you submitted in advance. I would say we are going to... After the virtual round tables, we'll be having another listening session similar to the one that kicked this off. I think, Steve, you spoke there. I don't. But it'll be another... give people a chance, stakeholders a chance to respond to things that they may have seen or thought about since we started this. In addition, currently on the website, the portal is open for submitting new additional written comments. So, I think those will be particularly helpful. We've heard a lot of great ideas in the verbal format, but any additional thoughts that you might have that you'd like to submit, I'd certainly invite that and invite those watching on the stream to do that. As I mentioned, this is the 16th. I want to just thank our team again. They've done a lot of work to pull these things together on relatively short notice and it's been a tremendous help to those of us who sit here. But obviously, there's a lot of work that goes into the back, both the people running the events, the teams in the bank regulation or office of general counsel, notwithstanding the disclaimer. I'm sorry. But it has been a tremendous, tremendous lift and people have done a great job. So, I want to thank them, thank the director for kicking this off, and thank those of you who watched on the livestream. So, thanks again and appreciate it.