NEWS

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PREPARED TESTIMONY OF RONALD A. ROSENFELD CHAIRMAN, FEDERAL HOUSING FINANCE BOARD BEFORE THE SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE AND GOVERNMENT SPONSORED ENTERPRISES

Thank you, Chairman Baker, Ranking Member Kanjorski, and distinguished members of the subcommittee. I appreciate the opportunity to present a statement to you about the Federal Housing Finance Board (Finance Board) and the Federal Home Loan Bank System (FHLBank System).

It has been more than a year since I appeared before this subcommittee, and a great deal has happened during that time. Today, I will update you on the performance and condition of the FHLBanks, highlight the actions the Finance Board has taken to enhance the safety and soundness of the System, and provide an overview of the actions we have undertaken to improve our oversight capabilities. I am confident that these steps benefit the public who are served by the housing finance and community development activities of the FHLBanks, as well as the FHLBanks and their shareholder/member institutions.

Before I address specifically the Finance Board and the FHLBank System, I would like to stress the need for reform of the supervision and regulation of the government-sponsored enterprises (GSE). The housing GSEs – Fannie Mae, Freddie Mac, and the 12 FHLBanks – are large complex entities. They are important to the nation’s housing market and play a vital role in the financial markets. Thus, they should be overseen by a single strong independent regulator that has the full arsenal of supervisory and enforcement tools to ensure that they are operated in a safe and sound manner consistent with their mission.

Let me next share with you some observations. They are observations drawn from the first 18 months of my tenure as chairman of the Finance Board and they underpin the regulatory and supervisory operations of the Finance Board. The environment in which the FHLBanks operate has changed during the last five years. There has been further consolidation in the financial services industry, increased use of derivatives to hedge mortgage activity, and changes in accounting, including adoption of new standards for accounting for derivatives. Those changes brought about increased risks and challenges to the business of the FHLBanks and contributed to increased earnings volatility. In some important instances, the FHLBanks did not respond quickly enough to keep pace with the changing environment. Many FHLBanks did not embrace and implement governance and risk management tools appropriate for the size and sophistication of their evolving business. The combination of inadequate skills and poor judgment created serious problems. An example is the initial rapid growth in the mortgage programs at some of the FHLBanks. The risks associated with and universally known to exist with portfolios of 30-year, fixed-rate mortgage loans were neither fully appreciated nor well-managed.

At the same time, the Finance Board had inadequate staff and technology. Just five years ago, the Finance Board had eight bank examiners and did not have the necessary risk models. Today, we have 30 safety and soundness examiners and mortgage specialists and seven Affordable Housing Program (AHP) and Community Investment examiners. The average experience of these examiners is over 15 years. In addition to the examiners and mortgage specialists, other personnel such as accountants, analysts, and economists, participate in at least a portion of the on-site examinations. Our technology has been upgraded, and we are now better able to model the FHLBanks' risks, particularly the interest-rate risk in mortgage portfolios.

The FHLBanks and the Federal Housing Finance Board have undergone significant changes and faced serious challenges in the last few years. We have each learned some important lessons. The FHLBanks learned lessons in governance and risk management. The Finance Board learned the benefits and need for early and resolute action when problems emerge.

Background

The Finance Board's primary duty is to ensure that the 12 FHLBanks and their joint office, the Office of Finance, operate in a financially safe and sound manner. In addition, the Finance Board ensures that the FHLBanks carry out their housing finance and community lending mission, remain adequately capitalized, and are able to raise funds in the capital markets. The Federal Home Loan Bank Act requires the Finance Board to examine each FHLBank at least annually. Finally, the Finance Board is a non-appropriated agency that sets its own budget; it assesses the FHLBanks for the costs of its operation.

The 12 FHLBanks and the Office of Finance serve the public by promoting the availability of housing finance through more than 8,100 member institutions. The FHLBanks provide a readily available, low-cost source of funds to members and a secondary market facility for home mortgages originated or acquired by their members. The FHLBanks are cooperatives; members own the stock of each FHLBank, and the members receive dividends on their investment. Insured banks, thrifts, credit unions, and insurance companies engaged in housing finance can apply for membership.

The FHLBanks play a unique role in housing finance. They make collateralized loans, called advances, to their members and eligible housing associates (principally state housing finance agencies). The advances are secured by mortgages and other eligible collateral pledged by members, housing associates, and their affiliates. Advances generally support mortgage originations, provide term funding for portfolio lending, and may be used to provide funds to any member “community financial institution” (an FDIC-insured institution with assets of $587 million or less) for loans to small business, small farms, and small agribusiness. This flexibility allows these advances to support diverse housing markets, including those focused on low- and moderate-income households.

FHLBank advances can provide funding to smaller lenders that otherwise have limited access to funding sources. Smaller community lenders often lack access to funding alternatives available to larger financial entities, including repurchase agreements, commercial paper, and large deposits. FHLBank advances offer these lenders access to competitively priced wholesale funding.

Finance Board Operations

The Finance Board’s fiscal year 2006 budget is $35,873,000, almost the same as the previous year’s budget. I expect little change in the fiscal year 2007 budget from the 2006 budget. More than one-half of the Finance Board’s budget in fiscal year 2006, $18,745,000, is budgeted for our Office of Supervision, which is responsible for on-site safety and soundness and AHP examinations, off-site monitoring of the 12 FHLBanks, and examination and monitoring of the Office of Finance. In addition, much of the remainder of the budget, including our information technology and legal budgets, goes to agency activities that directly or indirectly support our supervisory programs. The Finance Board is a careful steward of the funds we assess the FHLBanks. As the above figures show, our expenditures are for activities that support the Finance Board’s primary statutory duty—ensuring the safety and soundness of the FHLBanks.

Two overarching principles guide the supervisory activities of the Finance Board – one is the regulatory independence of the agency and the other is the Finance Board’s expectation that the FHLBanks operate consistent with high standards of governance and risk management. By regulatory independence I mean that the Finance Board is an arms-length regulator. While we have interests in common with the System – the desire for strong earnings, strong capital, fulfillment of mission, and others – our responsibilities are nonetheless those of a safety and soundness and mission regulator.

With regard to the second principle, we expect the directors and management of the FHLBanks to adhere to the highest standards of ethics, corporate governance, accounting, and risk management. As GSEs, the FHLBanks enjoy a special privilege in the capital markets. Consistent with that privilege, we also expect the Banks, as government-sponsored enterprises, to maintain low risk profiles. The joint and several liability that the FHLBanks have for the System's consolidated obligations also underscores the need for each individual FHLBank to operate with high standards.

In March 2005, when I last appeared before this committee, I reported on four supervisory initiatives, each of which is consistent with those overarching principles. Those initiatives remain pertinent to our supervisory and regulatory efforts. First, in late 2005, we began a program to collect information from the FHLBanks to measure and monitor the interest-rate risk in their mortgage portfolios. We spend more resources on risk measurement, monitoring, and assessment than any other single supervisory area. For example, we measure the effects of various interest rate changes and pass that information to our supervisory staff. With this information, examiners and economists are able to have more informed discussions with the FHLBanks and their boards of directors about risk exposures, risk measurement and modeling, and the implications of possible interest rate movements on earnings, capital, and dividends.

Second, in 2005 we instituted a quarterly visitation program. The program calls for the examiner-in-charge of each FHLBank, along with one or two staff members, to visit the FHLBank once a quarter between annual examinations. We have found these visits to be an effective way to follow-up on examination issues and other developments, including changes to business strategies and risk exposures. We are continuing to refine the visitation program. In situations where there are no significant supervisory concerns, the quarterly visitations will be extended to semi-annual visitations to lessen burden and conserve Finance Board resources for supervision of higher risk activities. In other cases, the visitation may be semi-annual, but expanded to include a targeted examination with a team of examiners and other staff participating.

Third, we continue to emphasize corporate governance and risk management, two critical elements of sound banking practice. To further better governance at the FHLBanks, in 2006 we amended our regulations regarding director eligibility. Those amendments permit the FHLBanks to be more involved in identifying stewardship needs and in assuring that elected directors meet those needs. In addition, we intend to include an explicit assessment of corporate governance in the examination rating system that we plan to implement in 2007.

And fourth, I committed that we would provide additional guidance regarding the Affordable Housing Program. The AHP was created when Congress passed the Financial Institutions Reform, Recovery, and Enforcement Act of 1989. From inception through 2006, FHLBank contributions to the AHP total $2.5 billion and the funds used to develop, rehabilitate, or finance more than 519,000 housing units. In December 2005 the Finance Board had issued for comment a revised Affordable Housing Program regulation that will streamline and reorganize the regulation. The comments were generally positive, but did raise some issues that Finance Board staff is working on before finalizing the rule. That rule is scheduled to be considered by our board of directors later this month.

In addition to these initiatives, the Finance Board continues to enhance its supervisory capabilities. The number of supervisory staff has increased, enhancements were made to our examination guidance and supervisory program, and we continue to look for other ways to ensure our supervisory efforts are relevant and risk-focused. For example, later this month our Office of Supervision will be seeking comments on a rating system for the FHLBanks. The new rating system will further enhance our communication with the FHLBanks, make our examination process more transparent, and enable us to better focus our examination and supervision on those FHLBanks and on those areas within FHLBanks that are of greatest supervisory concern.

Condition and Performance of the Banks

At June 30, 2006, the combined assets of the 12 FHLBanks were $1.024 trillion, up from $1.003 trillion at the end of 2005. If the FHLBanks were a bank holding company, they would be the fourth largest bank holding company in the country, smaller only than Citigroup, JP Morgan Chase, and Bank of America.

Loans to members, or advances, are the largest asset class constituting 62 percent of assets. (See Chart 1.) Advances of $638 billion are 0.5 percent higher now than at the end of 2005. Mortgage loans purchased from members are $102 billion or 10 percent of assets. After reaching a peak of almost $116 billion in June 2004, mortgage loans have been trending downward. This downtrend reflects general mortgage market conditions that are unfavorable toward the acquisition and holding of fixed-rate conforming mortgages as well as strategic decisions by several FHLBanks to de-emphasize the holding of mortgage loans.

Advances concentrations reflect the concentration of assets in the financial services industry. The top 10 holders of advances account for 33 percent of the System total of advances. (See Charts 2 and 3.) Mortgage purchases are more heavily concentrated than advances. Almost 70 percent of mortgages in the FHLBank System were purchased from 10 members. (See Chart 4.) As of year-end 2005, three FHLBanks, Des Moines, Pittsburgh, and Seattle, had portfolios with more than 80 percent of their mortgages from a single member. (See Chart 5.)

The FHLBanks hold investment portfolios totaling $230 billion or 23 percent of assets. At June 30, 2006, these investment portfolios are primarily mortgage-backed securities ($128 billion), prime short-term money-market instruments ($83 billion), and federal agency securities ($19 billion).

The FHLBanks principally fund their operations by issuing consolidated debt obligations for which each FHLBank is jointly and severally liable. The consolidated debt obligations are issued by the Office of Finance. Outstanding consolidated obligations are $939 billion.

The total capital of the FHLBanks is $45.5 billion or 4.44 percent of assets. Total capital comprises all stock issued by the FHLBanks plus retained earnings. Of that total, retained earnings are $3.0 billion or 0.30 percent of assets.

In the first six months of 2006 the FHLBanks' net income was $1.258 billion compared with $900 million for the comparable period of 2005. The return on assets was 0.25 percent compared with 0.19 percent in the first half of 2005. The improvement in reported profitability is attributable to the rise in interest rates in 2006 that has increased the FHLBanks' returns on invested capital.

Regulatory Actions

The Finance Board has undertaken three important regulatory initiatives over the course of the last several years. One is the proposed revision and update of the AHP regulation that was described previously. The other two initiatives are the rule requiring SEC registration by the FHLBanks and a proposed rule on retained earnings and excess stock.

SEC Registration Final Regulation

The FHLBanks are large financial institutions. They range in size from $40 billion to over $200 billion. There was no legitimate reason that institutions of that size, sophistication, and importance should not be SEC registrants. As of August 8, 2006, all 12 FHLBanks are now SEC registrants, a process that took nearly two years. Looking back, the rule requiring SEC registration, the process undertaken by the FHLBanks to meet regulation requirements, and the outcomes are all positive. The process undertaken by the FHLBanks to meet the rule's requirements entailed an accounting review by the world's accounting expert, the SEC. The review identified incorrect accounting treatment at some of the FHLBanks, most typically related to their hedging activities. As a result, half of the FHLBanks either have or will restate prior period financial statements. In addition to identifying improper accounting in some instances, the process surfaced inadequacies in the FHLBanks' financial accounting systems and personnel.

The outcomes, particularly greater transparency in the FHLBanks' financial reports, are similarly beneficial. Investors and others now have a full and fair view of the financial condition and performance of each of the FHLBanks; a view by which each FHLBank can now be more easily compared to each other. Each of the FHLBanks is able to better understand the operations and condition of the other FHLBanks; something that is critical in light of the joint and several liability each has for the debt issued on behalf of the other FHLBanks.

As a consequence of the registration process and the resulting restatements, the combined financial statements for the System for 2004 and 2005, prepared and published by the Office of Finance, have been delayed. Finance Board staff is in discussion with the Office of Finance regarding the timing of publication of those statements. The timing will depend in large part on resolution of remaining questions the SEC has regarding the hedge accounting at one FHLBank. I expect, however, that the 2005 and 2004 annual financial statements will be available before this year-end.

In anticipation of the release of financial statements for each FHLBank, the Finance Board, in July, issued an Advisory Bulletin to the FHLBanks removing any regulatory impediments for disclosing "unpublished information" to the extent it would need to be disclosed for an FHLBank to meet its obligations under the securities laws. The most important "unpublished information" covered by that bulletin is the factual content in examination reports. While we did not authorize the release of examination reports, we authorized the FHLBanks to disclose information that would be necessary for a user of its financial statements to understand any material effects the supervisory process might have on an FHLBank's future operations or its financial condition and performance.

Retained Earnings and Excess Stock Proposed Regulation

In April 2006, the Finance Board issued for public comment a proposed rule to strengthen the capital composition of the FHLBanks. The proposed capital rule on retained earnings and excess stock was issued for a 120-day comment period, which closed on July 13, 2006. We are in the process of reviewing and analyzing the 1,066 comments that we received on the proposal. I assure you that we are taking an open-minded and cautious approach to the rulemaking. Any steps that we take will conform fully to the capital provisions of the Gramm-Leach-Bliley Act of 1999 (GLB), and we will carefully consider the comments we have received through the rulemaking process.

Retained earnings are a critically important component of capital for the FHLBanks. Increased holdings of mortgage assets, with long contractual lives and borrower prepayment options, coupled with adoption of Statement of Financial Accounting Standards 133, have contributed to higher market risk exposure and greater earnings fluctuations among the FHLBanks. In light of the statutory mandate that FHLBank stock trade at par, retained earnings must be sufficient to absorb losses in reported income if impairment to the par value of members' capital stock is to be avoided. The case for adequate levels of retained earnings is straightforward and compelling. If losses exceed retained earnings in any FHLBank, (i) accountants could compel FHLBank members to write down the value of their FHLBank stock, (ii) regulators could increase the capital charge against FHLBank stock, and (iii) members could limit new borrowing from the FHLBank to avoid having to acquire additional FHLBank stock that could have to be written down to reflect impairment.

The proposed regulation is only the most recent in a series of steps the Finance Board has taken in the past three years to strengthen the capital management of the

FHLBanks. On August 18, 2003, the Finance Board's Office of Supervision issued an Advisory Bulletin requiring each of the FHLBanks to adopt a capital management and retained earnings policy, which should include, at least annually, an assessment of the adequacy of its retained earnings in light of alternative possible future financial and economic scenarios. Since that time, capital management and retained earnings have been one focus of our annual examinations, and the FHLBanks have made progress in increasing their retained earnings. The progress, however, has been modest and uneven among the FHLBanks, and inadequate at some.

Excess stock, also referred to as "voluntary stock," is not excess capital for the FHLBank. Rather, it is capital stock that a member holds in excess of the amount of membership stock and/or activity stock that it is required to purchase as a condition of membership or to support activities with the FHLBank.

Excess stock presents three principal issues for the Finance Board. First, member institutions that hold excess stock as an "investment" can redeem excess stock at par value without curtailing their activities with the FHLBank or withdrawing from membership. This "investment" purpose makes excess stock a less dependable source of capitalization than required membership or activity stock. Second, excess stock is typically used to capitalize non-advance assets, such as mortgages, mortgage-backed securities, and other investments. Using shorter-term, redeemable capital to capitalize mortgages or other long-term assets is also undesirable from a safety and soundness perspective to the extent that redeemable capital is supporting long-term assets. Third, using excess stock to capitalize investment securities beyond an amount needed for primary liquidity is undesirable from a public-policy perspective to the extent that the government-sponsored enterprise borrowing privilege is being used to "arbitrage" the GSE advantage to fund activities that are not related to the FHLBanks' core mission.

In light of those concerns, the proposed rule establishes a minimum required level of retained earnings, limits dividends if an FHLBank is below its retained earnings requirement, and restricts an FHLBank's reliance on excess stock. Recognizing the significance of the proposed rule, we provided for a 120-day comment period, which is substantially longer than normal.

We received over 1,000 comments, most calling for modification of the proposal and some calling for us to withdraw the proposal. I would say the following, and I should preface my remarks by saying that I am speaking for myself, not my colleagues or the board of directors as a body. There has been nothing in the debate to this point in time that would compel me to favor withdrawing the proposal. So long as there is a statutory provision that the capital stock is to be bought and sold at par value, retained earnings is the "operating capital" of the FHLBanks. It is critically important that retained earnings be sufficient to protect the par value of the capital stock from impairment. With respect to the proposal regarding excess stock and stock dividends, we have some rather sobering experiences that demonstrate that excess stock can create instability in an FHLBank's capital. We also have seen FHLBanks engage in either "non-mission" activities or otherwise more risky activities to generate returns on excess capital.

The comments did raise issues that deserve consideration. The primary issues are: the limitation on dividends until an FHLBank reaches the minimum retained earnings level; the prohibition on stock dividends; and the fact that the rule treats all non-advance assets the same, regardless of risk or tenor.

The proposed rule imposes a limitation on dividends of 50 percent of income until an FHLBank reaches its retained earnings requirement, unless the Finance Board approves otherwise. The 50 percent limit was proposed under the presumption that it would be inappropriate for an FHLBank's dividend payout to exceed its income retention until it has reached its minimum level of retained earnings. Many commenters questioned the 50 percent dividend payout limit, absent an immediate safety and soundness issue. That is a constructive observation, and we should consider a higher dividend payout ratio which would extend the time for the FHLBanks to reach the retained earnings minimum.

With respect to the prohibition on stock dividends, the issue is really one of excess stock. Those commenting suggested that if the Finance Board will accept some level of excess stock, which the proposed regulation does allow, we should not determine how a member accumulates that excess stock. It is a reasonable inquiry that we can pursue.

Finally, it was also widely-suggested that assets be risk-weighted for purposes of determining the required minimum level of retained earnings, instead of a flat one percent requirement for non-advance assets. For example, our proposal treats mortgage loans the same as cash and Treasury securities. It also treats short-term assets the same as long-term assets. We should consider whether adjusting the level of retained earnings held for different categories of assets with different risk characteristics is appropriate. Should we take that approach, I expect it would be a simple risk-based capital framework.

While the timing of a final capital regulation is uncertain, our actions will take into account the consequences of any rulemaking on the FHLBanks and their members. We will be guided by three principles as we proceed to a final rule:

- Our regulation should not impede good business judgment about the composition of an FHLBank's balance sheet.

- Our regulation should not materially alter the value of membership in an FHLBank. For example, the time allowed each FHLBank to reach its required level of retained earnings must reflect the need for each FHLBank to offer value to its members, including the members' expectations of a reasonable dividend yield on their investments in the FHLBank.

- Our regulation should recognize that where an FHLBank has engaged in prior conduct that was permissible under the then-existing rules, any change in those rules should afford the FHLBank a reasonable time to adjust its business strategies.

Any requirements affecting the capital composition of the FHLBanks or restrictions on the level or form of FHLBank dividends will balance our regulatory and supervisory interests with the need for the FHLBanks to offer value to their members.

Supervisory Agreements

The Seattle and Chicago Banks continue to operate under Written Agreements with the Finance Board. While the particulars of each case are different, in both instances the Banks took actions and engaged in business activities that were imprudent. Both had a high level of excess stock and both were intent on growing their mortgage portfolios.

The Seattle Bank was operating with too much excess stock and too little retained earnings. To generate returns on the excess stock, the Seattle Bank imprudently grew its mortgage portfolio and took interest-rate risk in its investment portfolio. When the problems were identified, the Seattle Bank had insufficient retained earnings to deal comprehensively with them, thus a supervisory action was necessary. That action prohibits the payment of dividends, thereby increasing retained earnings, and prohibits the repurchase of members' stock. The problems at the Seattle Bank are now under control, although the situation is a long-term workout.

The Chicago Bank grew its mortgage portfolio by relying on excess stock. The mortgage portfolio increased to 60 percent of assets and was supported by a commensurate amount of member excess stock. Thus, it was supporting long-term assets with stock that had a six-month call by the members. Safety and soundness issues related to its high level of excess stock intensified when its earnings declined and it lowered dividends in a rising interest-rate environment. As a consequence of the reduced dividend payout, virtually all shareholders wanted their excess stock repurchased to take advantage of higher returns on alternative investments.

In the case of the Chicago Bank we needed to act immediately. There was a loss of confidence by the member/shareholders as evidenced in 2005 by members seeking repurchase of hundreds of millions of dollars in excess or voluntary capital stock. In deliberating various solutions, we established and strictly adhered to several principles. Specifically, the solution:

- Must be complete and offer a way forward. We would not entertain a "fix," *i.e.*, an option that served only put off until another day, and to someone else's watch, a crisis;

- Must provide the Bank sufficient time and flexibility to deal with its embedded financial problems;

- Must not erode the protection of holders of consolidated obligations;

- Must place any costs that might be realized first at the doorstep of the Bank's member/shareholders; and

- Must be limited in reach, *i.e.*, it should not be one that sets precedent or opens the door to "creative" funding or capital activities for other Banks.

Against those five principles, we explored various options. In addition to permitting the Bank to issue subordinated debt, the options were: permitting the Bank to issue consolidated debt to redeem voluntary stock; requiring the Chicago Bank to shrink its assets; combining the Chicago Bank with another FHLBank; prohibiting redemptions of any stock; prohibiting stock redemptions except in the case of members who were withdrawing from the Chicago Bank; and allowing the other FHLBanks to buy the debt of the Chicago Bank. Each of the options was carefully explored and analyzed. As we worked through all the options, it became clear to us that, especially given the time available, the only one that met each of the five aforementioned principles was the subordinated debt option.

We authorized the Chicago Bank to issue 10-year subordinated debt with a fixed rate of 5.625 percent. The debt, under certain conditions and with certain limitations, can be used by the FHLBank to satisfy a portion of its regulatory leverage requirements. The principal limitation is that until the Chicago Bank converts to a new capital plan under the Gramm-Leach-Bliley Act, the amount of subordinated debt that can be used to satisfy the Bank's leverage requirement is phased-out over the last five years of the instrument.

Part of our analysis was a legal review of the transaction. While GLB limits the types of instruments that an FHLBank can use to satisfy the statutory capital requirements, the Chicago Bank has not yet converted to a post-GLB capital plan, and thus is not subject to the capital provisions of the GLB Act. Consequently, subordinated debt can be used to satisfy the regulatory leverage requirement of the Chicago Bank; it cannot be used for this purpose at any other FHLBank. Therefore, the approval of the issuance of subordinated debt will be limited to this one case only.

Now, some 90 days after the transaction, I can say with confidence that the "subordinated debt solution" was the right one. We kept to the principles we established. We provided the Chicago Bank and its new management team time to work through and resolve financial issues, and we replaced $1 billion in shorter-term, redeemable capital, *i.e.*, excess stock, with 10-year subordinated debt.

Conclusion

At the Finance Board, the focus of our supervisory program has shifted over the past five years. It has moved from one in which our examinations were more oriented to compliance with Finance Board rules and the FHLBanks' internal policies to one that emphasizes strong governance, risk management and controls, and the effective implementation and administration of the Affordable Housing Program. Our supervisory program and regulatory approach now better addresses the risks inherent in the activities conducted by the FHLBanks today and into the future. I am pleased with the progress that has been accomplished, and I am optimistic about the improvements that are underway.

The FHLBank System is financially safe and sound. While there are particular supervisory problems, they are under control. Moving forward, our regulatory focus will be on realizing the enhancements to the FHLBanks' capital structure envisioned by the Gramm-Leach-Bliley Act of 1999. Our supervisory focus will be to continue to be preemptive so supervisory issues do not become safety and soundness problems.

Chairman Baker, Ranking Member Kanjorski, and members of the subcommittee, thank you for the opportunity to report on the condition of the FHLBank System and the Federal Housing Finance Board.

Chart 1

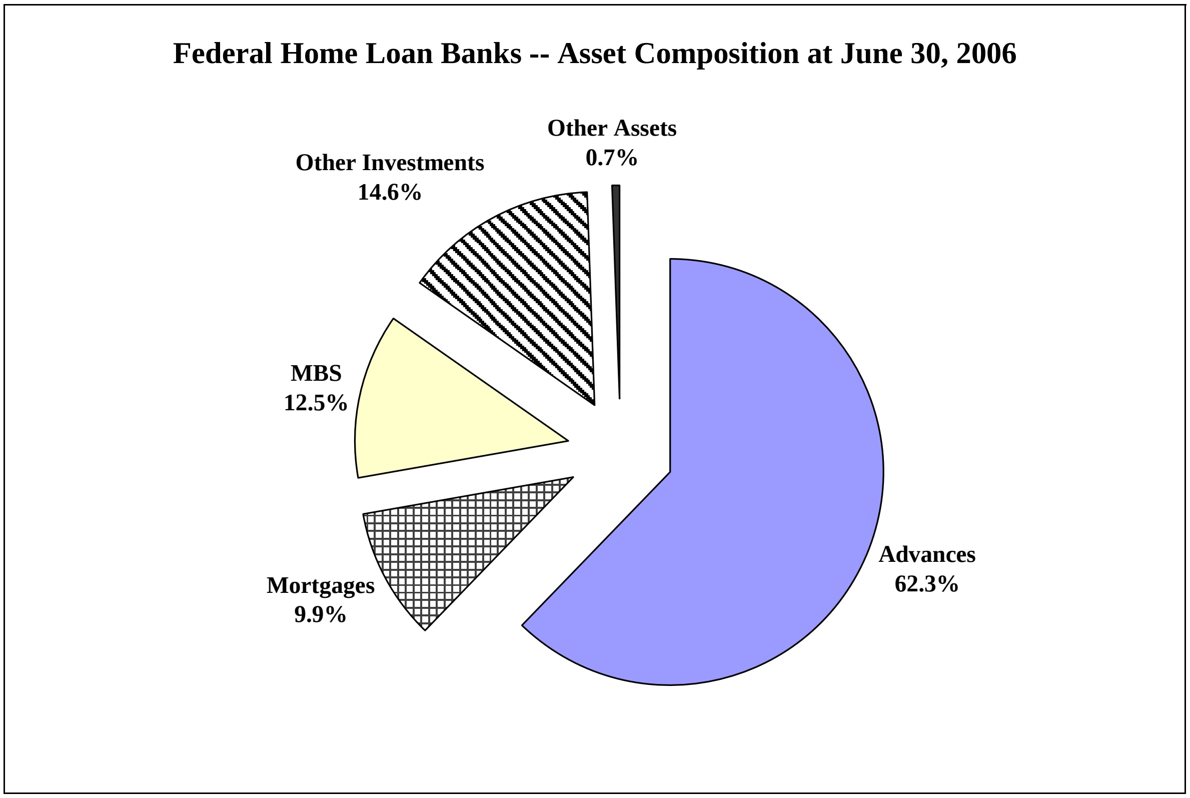

Federal Home Loan Banks -- Asset Composition at June 30, 2006
Other Assets
0.7%
Other Investments
14.6%
MBS
12.5%
Mortgages
9.9%
Advances
62.3%

Chart 2

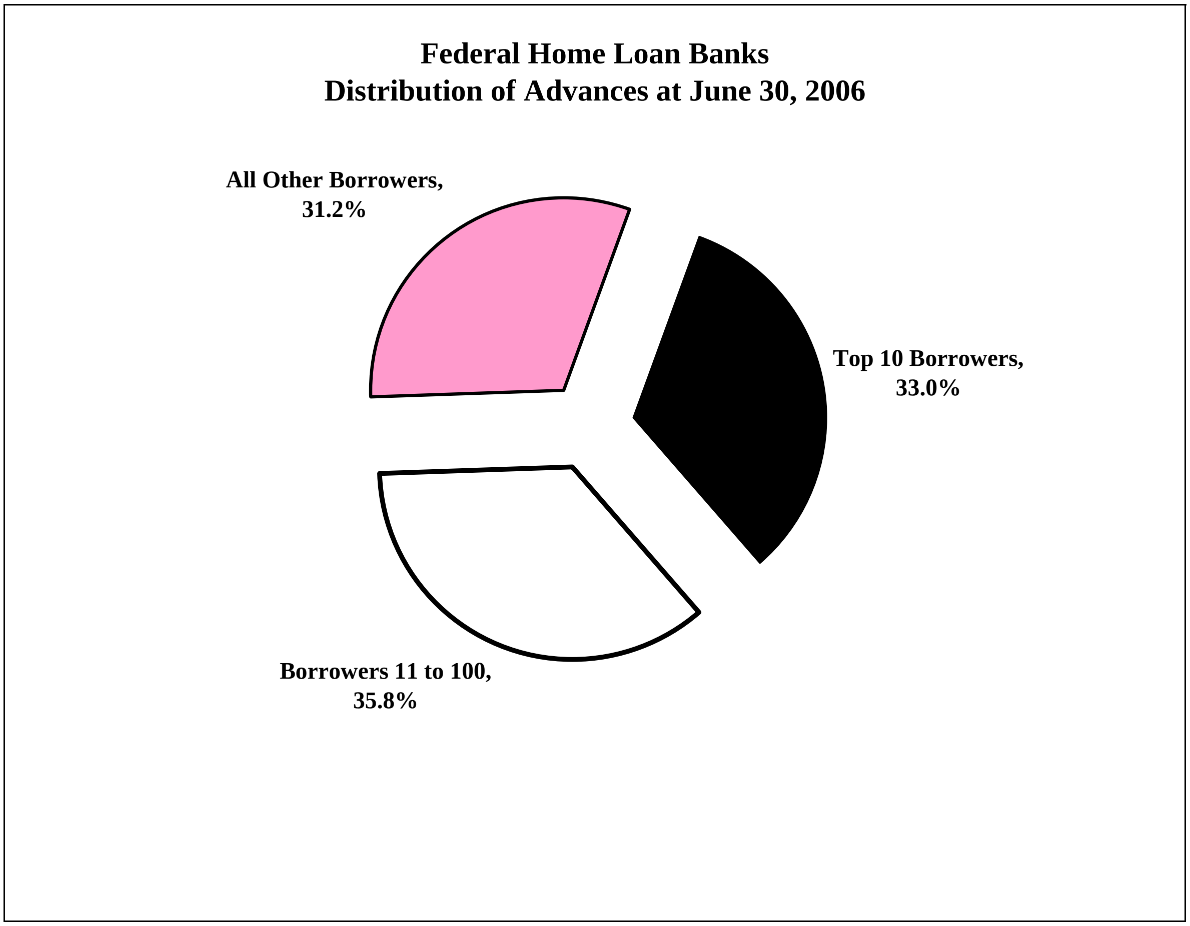

Federal Home Loan Banks
Distribution of Advances at June 30, 2006
All Other Borrowers, 31.2%
Top 10 Borrowers, 33.0%
Borrowers 11 to 100, 35.8%

Chart 3

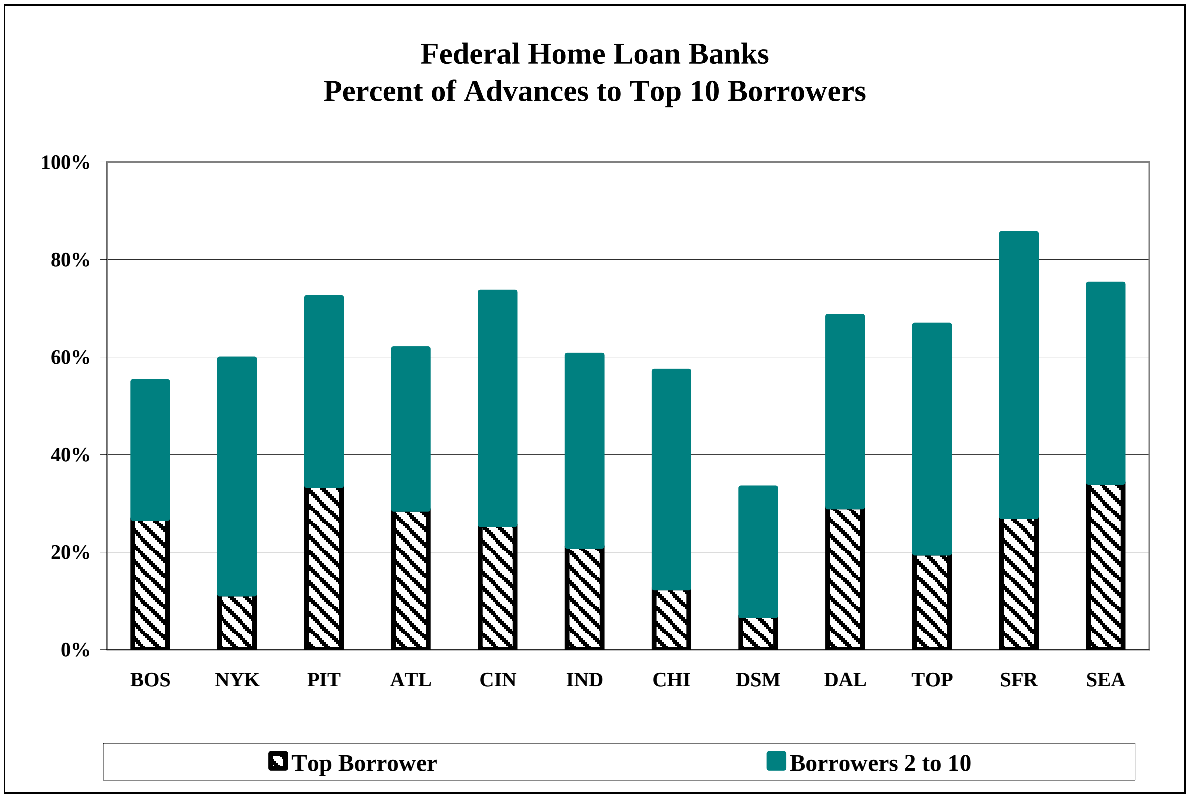

Federal Home Loan Banks
Percent of Advances to Top 10 Borrowers
100%
80%
60%
40%
20%
0%
BOS
NYK
PIT
ATL
CIN
IND
CHI
DSM
DAL
TOP
SFR
SEA
Top Borrower
Borrowers 2 to 10

Chart 4

Federal Home Loan Banks -- Providers of Mortgage Loans Based on Outstanding Balance at December 31, 2005

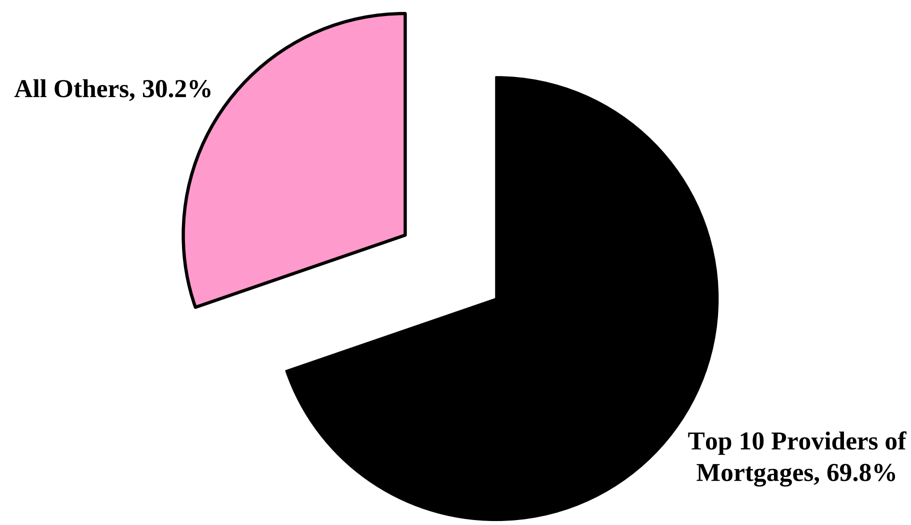
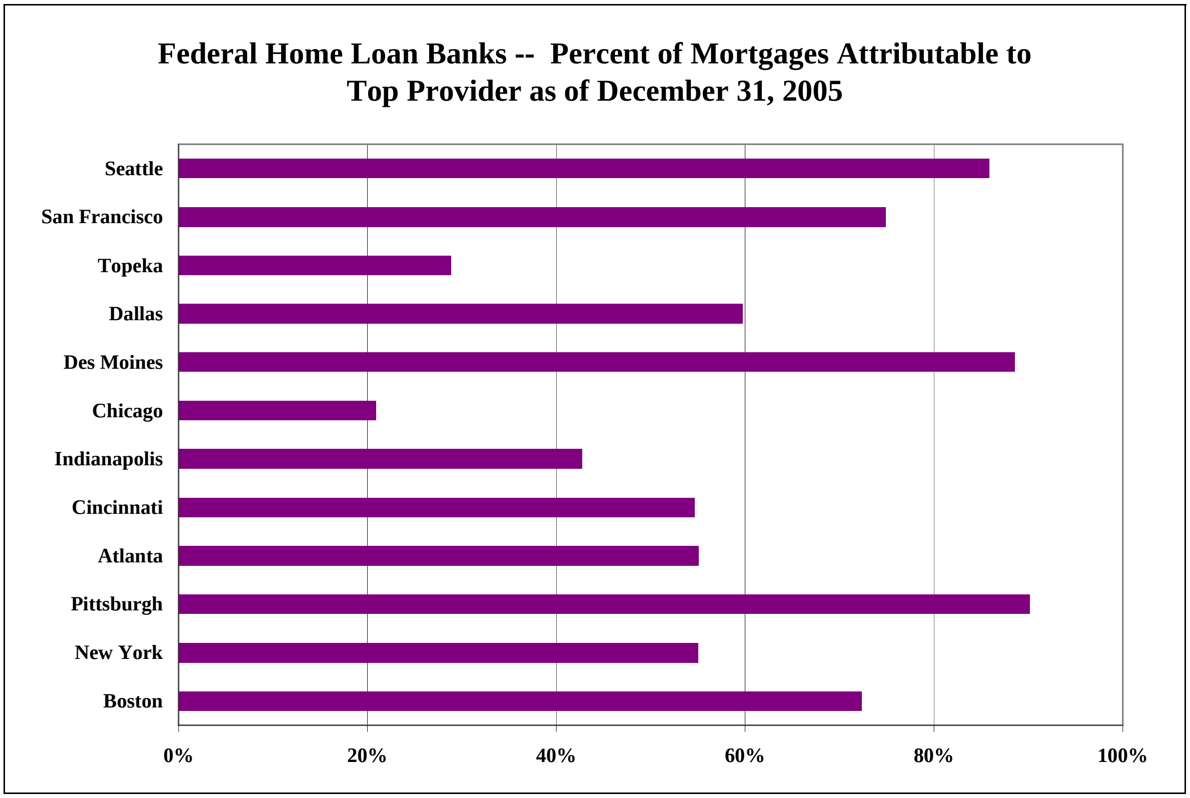


Chart 5



The Federal Housing Finance Board is an independent agency in the executive branch that oversees the safety, soundness, and mission of the 12 regional Federal Home Loan Banks. The Banks are government-sponsored enterprises created in 1932 to provide low-cost funding for housing finance. They have more than 8,100 financial institutions as members, including commercial banks, savings and loans, insurance companies and federally insured credit unions. More information can be found at http://www.FHFB.gov

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