

## FEDERAL HOUSING FINANCE BOARD

In the Matter of:

OPEN MEETING

Second Floor  
Federal Housing Finance Board  
1777 F Street, N.W.  
Washington, D.C. 20006

Thursday,  
June 29, 2000

The hearing in the above-entitled matter was  
convened, pursuant to Notice, at 2:10 p.m.

BEFORE: BRUCE A. MORRISON, Chairman

APPEARANCES:

Board Members:

WILLIAM C. APGAR  
J. TIMOTHY O'NEILL

Staff:

WILLIAM W. GINSBERG  
SCOTT L. SMITH  
JAMES L. BOTHWELL  
JULIE PALLER  
ERIC RAUDENBUSH  
DEBORAH F. SILBERMAN  
ERIC BERG

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<p style="padding-left: 40px;">Finance Board consideration of a final rule that would authorize the Banks to acquire member assets and define core mission activities and establish parameters for such investments.</p>	
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<p style="padding-left: 40px;">Final Rule revising Finance Board advance regulations to implement Gramm-Leach-Bliley provisions that allow all members to pledge additional collateral as security for advances, allow community financial institutions to obtain advances for additional purposes and secure those advances with new types of collateral and revisions to other Finance Board regulations related to above.</p>	

P R O C E E D I N G S

(2:10 p.m.)

CHAIRMAN MORRISON: The meeting will come to order. The first item on the agenda, Final Rule: The FHLB acquired member assets, core mission activities, investment, and advances. Mr. Ginsberg.

MR. GINSBERG: Mr. Chairman, thank you, and members of the Board. Good afternoon. This final rule would authorize the Federal Home Loan Banks to acquire acquired member assets and would define core-mission activities of the Banks for purposes of the Banks' strategic-business- planning process as required by regulation.

This final rule represents the culminating step in what have been two lengthy processes for the Finance Board.

First, the moving of the Banks' mortgage-purchase activities from and through their pilot stage to the stage of being an authorized product, and with the adoption of this final rule that process would have been completed.

This process has taken almost four years. The Federal Home Loan Banks today have on their balance sheets almost \$10 billion worth of these acquired-member assets. These programs have changed and evolved. We've learned much, and the Banks have learn much, through this pilot stage, and we have come to a structure, an authorizing

1 structure, that's in the final rule that preserves the  
2 cooperative nature of the System that's consistent with the  
3 safe and sound financial operation of the System and that  
4 has a clear place in the marketplace in terms of a product  
5 that has market acceptance.

6           The second lengthy process that this rule relates  
7 to the mission regulation. This Board started down the path  
8 some time ago of looking at its duty to ensure that the  
9 Banks carry out their housing- finance mission not just  
10 solely from the perspective of that portion of the Banks'  
11 balance sheets or the Banks' profits that go to supporting  
12 particularly underserved markets, but looking at the  
13 question of mission with reference to total balance sheet of  
14 the Banks as a whole, defining mission, and then defining  
15 how the balance sheet as a whole of the Federal Home Loan  
16 Bank stacks up against that regulatory definition of the  
17 mission. And that is what the final rule would do on that  
18 front, without limiting, I should say, the balance sheets of  
19 the Banks, but stacking up the balance sheet against the  
20 regulatory definition of mission.

21           So for both of those reasons this is an important  
22 step in the evolution of the regulatory regime governing the  
23 Federal Home Loan Banks. Our staff has labored long and  
24 hard on these issues, my colleagues here at the table with  
25 me and many others, and I'm going to ask Scott Smith, deputy

1 director in the Office of Policy, to present the details of  
2 the rule. Scott?

3 MR. SMITH: Thank you, Will. Good afternoon, Mr.  
4 Chairman and Directors Apgar and O'Neill. The staff is  
5 requesting the Board of Directors consider and approve the  
6 final rule on acquired member assets, AMA; core mission  
7 assets, CMA; investments and advances.

8 This rule would broaden the authority of the Banks  
9 to engage in new and existing business activities with their  
10 member institutions and associates while imposing  
11 risk-management requirements that are consistent with the  
12 existing rules governing safety and soundness. It would  
13 also clarify a requirement of the Banks to address core-  
14 mission activities in their strategic plans.

15 The Finance Board received just over 100 comment  
16 letters about the proposed rule, including letters from all  
17 of the Federal Home Loan Bank members, housing groups, and  
18 trade associations. In general, the comment letters focused  
19 either on CMA or AMA and commenters on their support of the  
20 proposed rule.

21 In keeping with the Finance Board's duty to ensure  
22 that the Banks fulfill their statutory mission, as described  
23 in Section 940.2, the new Section 940.3 clarifies which  
24 activities are to qualify as core mission. This  
25 clarification is needed at this time to provide guidance to

1 the Banks as they work to complete their strategic plans as  
2 required by Section 917.5. These plans will be key  
3 components of each Bank's capital-structure plan to  
4 implement the new, risk-based capital structure as required  
5 by the Modernization Act. However, aside from  
6 strategic-business-plan requirement, there currently are no  
7 other regulatory requirements pertaining to CMA.

8 As described in Section 940.3, activities that  
9 qualify as core mission are as described in the proposed  
10 rule, subject to minor changes, specifically in the area of  
11 targeted investments. However, there is one notable  
12 qualification, which is intended to encourage the Banks to  
13 acquire member assets from a broad array of what is  
14 available in the marketplace. Specifically, in  
15 going forward, a Bank or group of Banks may only count  
16 acquired, government-ensured or guaranteed loans as core  
17 mission up to 33 percent of all acquired member assets.

18 The majority of commenters on this provision of  
19 the rule were opposed to any such qualification, suggesting  
20 that the Banks should be provided maximum flexibility in  
21 meeting their members' needs. These comments were  
22 considered, but no change was made to the final rule because  
23 of the fact that the Banks' current mortgage portfolio is  
24 comprised of a high percentage of government-ensured loans.

25 Nonetheless, in the final rule this qualification

1 has been clarified such that the 33 percent shall be applied  
2 on a cumulative basis. Thus, government-ensured loans that  
3 would not qualify as core mission in Year 1 could qualify as  
4 CMA in Year 2 if in Year 2 there was an increase in the  
5 proportion of conventional loans acquired.

6 Also notable is that Bank investments in NBS would  
7 not qualify as a core-mission activity generally, as is  
8 consistent with the FMNA proposal from last year approved by  
9 the Board.

10 Under the proposed rule no NBS investments could  
11 qualify as core mission; however, after consideration of  
12 several comments on the proposed rule, the final rule now  
13 allows that certain NBS may qualify if it can be shown that  
14 they benefit households below a target income level and  
15 provide liquidity for such loans that is otherwise not  
16 adequately provided by the private sector and do not have a  
17 readily available or well-established secondary market.

18 As described in Part 955, the rule authorizes the  
19 Banks to acquire member assets, a category of assets that  
20 derives from changes contained in the Financial Services  
21 Modernization Act and from refinements to Finance Board  
22 requirements for mortgage-purchase programs. Specifically,  
23 the member assets of a Bank would have to be acquired from  
24 members and associates and would have to be whole loans that  
25 qualify as collateral for FHLB advances, and the

1 transactions must satisfy a risk-sharing requirement.

2           The risk-sharing requirement in the rule is a  
3 further refinement of what was contained in Resolution 99-50  
4 and in the proposed version of this rule. Several  
5 commenters expressed concern over the version in the  
6 proposed rule and suggested that the requirement be  
7 simplified to provide the Banks with greater flexibility in  
8 meeting the needs of the members.

9           The final rule reflects that suggestion but also  
10 adheres to several principles, namely, that the member must  
11 bear the credit risk in an amount sufficient to raise the  
12 credit quality of the Bank's investment to at least  
13 investment grade, the Bank must obtain verification from a  
14 nationally recognized, statistical-rating agency concerning  
15 the characterization of the enhancement structure, and that  
16 the structure provide the member with an incentive to  
17 minimize actual credit losses.

18           And just to clarify once again, HFA bonds or  
19 Housing Finance Agency bonds rated at least investment grade  
20 and government-ensured guaranteed loans would meet this  
21 risk-sharing structure.

22           An important consequence of this rule is that by  
23 authorizing the Banks to acquire member assets, that rule  
24 would replace the existing authorities for member  
25 mortgage-purchase programs, thus moving such programs,

1 including MPF, from pilot to permanent status.

2           Thirteen comments were received regarding the  
3 pilot status of the AMA programs, 11 of which were in favor  
4 of removing the pilot status. Generally, commenters noted  
5 the success of the current MPF program and that lifting the  
6 \$9 billion cap currently in place could provide further  
7 benefits to members and consumers. By considering AMA to be  
8 a core-mission activity, the Finance Board would, in  
9 essence, convert the AMA programs from pilot to permanent  
10 status, effectively removing the \$9 billion cap.

11           Finally, the rule contains an updated investment  
12 authority and a new provision for advances, both of which  
13 are included to achieve completeness and consistency with  
14 the other provisions of the rule. The new investment  
15 authority is subject, however, to applicable limitations in  
16 the FMP, the Financial Management Policy, and as set forth  
17 in the rule, ensuring the applicability of current  
18 risk-management requirements.

19           In addition, the rule contains a risk-based-  
20 capital requirement designed to reduce the credit risk of  
21 all assets acquired to no more than that afforded an asset  
22 rated to be at least the second-highest, credit-rating  
23 category by a nationally recognized, statistical-rating  
24 organization.

25           We would be happy to answer any questions.

1 CHAIRMAN MORRISON: By that you mean AA. Right?

2 MR. SMITH: Yes.

3 CHAIRMAN MORRISON: The language is precise but  
4 obscure.

5 Okay. I move the adoption of the rule with  
6 preamble as a whole and ask unanimous consent that the two  
7 consensus changes, one related to the procedure by which  
8 state housing authority bonds can be treated as core-mission  
9 assets and clarifying the continued vitality of the FMP  
10 under this regulation. If there is no objection, I will  
11 incorporate that in the base rule for consideration.  
12 Without objection, so ordered. And the resolution is before  
13 the members for comment and amendment.

14 MR. APGAR: Well, I defer first to Tim because not  
15 only all those comments, but every single commenter felt  
16 obligated to call me and test their comment, and I feel like  
17 I've had a fairly ample airing of this rule.

18 CHAIRMAN MORRISON: They are all sitting out  
19 there.

20 MR. APGAR: I tried to get back to you guys.  
21 Okay. But no. This is the culmination of a long-term  
22 effort to clearly identify what the Board judges to be  
23 core-mission activities, work that began long before I came,  
24 but has been ably led by our Chairman and Will, and the  
25 whole staff. So I think it's a good day that we've reached

1 this point.

2           There is always a discussion of whether or not it  
3 makes sense to move ahead before the capital rule has been  
4 advanced, and my sense is that until you have a clear  
5 understanding of what's in this rule, I think that will aid  
6 and significantly help the formulation of sensible capital  
7 requirements and then on to the business plans. So I'm  
8 comfortable we have the sequence right, I'm comfortable we  
9 have the timing right, and I know we've talked about this  
10 enough, and I'm prepared to move ahead, and I support the  
11 rule.

12           CHAIRMAN MORRISON: Mr. O'Neill?

13           MR. O'NEILL: I'll first thank the other Board  
14 members for the agreement on the Housing Finance Agency  
15 bonds. I think that was a good accommodation.

16           The amendment I have is the same amendment I made  
17 at the proposed rule, which is to strike the core-mission  
18 activities. First, let me say that I have no problem with  
19 the acquired-member assets raising the cap, the investment  
20 revisions, the advances provisions, but, and this is  
21 something that I have talked about with both the Chairman  
22 and Commissioner Apgar, and to me it's more an issue of  
23 timing than it is a difference in focus, but for me it  
24 basically comes down to two things.

25           First, I think that although I agree with both the

1 Chairman and Commissioner Apgar that we should be both the  
2 mission regulator as well as the safety-and-soundness  
3 regulator, I think that safety and soundness should always  
4 come first, and I think that this Board, under the  
5 leadership of the Chairman, has moved very quickly to  
6 implement different parts of Gramm-Leach-Bliley, and I think  
7 the most important part of that is the capital reg., and I  
8 think that we have a good start on that.

9 But one of the key points in the capital reg. is  
10 to incentivize the membership to buy Class B stock of the  
11 Banks, and my fear is by doing what we're doing on  
12 core-mission activities at this point it would frustrate, if  
13 not dissuade, members of the System for buying that stock.

14 I have two things from the preamble that I would  
15 bring out right now. First, on page five it says: "Many  
16 commenters stress their belief that the uncertainability of  
17 any Bank to maintain strong advances and pay an attractive  
18 dividend while focusing on the business activities  
19 enumerated in Section 940.3 could dissuade members and  
20 potential members for purchasing Bank stock."

21 Later on the same page it says: "Commenters  
22 expressed generally negative reactions to the proposal,  
23 raising concerns that the core-mission-activities provisions  
24 would limit the Banks' flexibility in managing their balance  
25 sheets, and, therefore, would adversely affect Bank profits

1 and possibly the safety and soundness of the Banks." That  
2 is my first concern.

3 My second concern is more dealing with Congress  
4 and the letters that we have gotten from Congressmen and  
5 Senators on this regard. As you know, we have had letters  
6 from six Senators and five Representatives saying that this  
7 should be delayed, but then more particularly, and I  
8 individually got a copy, my own letter, from Chairman Gramm,  
9 and Chairman Gramm says, as we understand them, recent  
10 proposals by the Board violate the spirit of the commitments  
11 embodied in the chairman's letter. Rather than proceeding  
12 once again down this troubled road, the Board should follow  
13 the priorities set for it by Congress and proceed with  
14 implementing the statutory instructions contained in the  
15 Gramm-Leach-Bliley Act.

16 I think that Chairman Gramm has it exactly right  
17 because nobody is saying that what we're doing here violates  
18 the letter of the Chairman's letter to Congress, but I think  
19 it definitely violates the spirit of that letter that the  
20 Chairman wrote. And for me, we should not, especially when  
21 somebody like the Chairman of the Senate Banking Committee  
22 asks us not to do this, we should not continue at this  
23 point.

24 And one of the things that I'm sure the Chairman  
25 will say in response to this is that if we're going to do

1 this, it's better to do it now because it lends certainty to  
2 the entire enterprise, but I think because of what has been  
3 in place in capital, the risk-based capital, and because of  
4 the Chicago pilot and the other pilots, there is a big  
5 chance that the Banks, their balance sheets will continue to  
6 be more mission related and less nonmission related. If  
7 that's the case, this is something that will happen as part  
8 of free-market forces, and I think that's a better way of  
9 going than we putting down our marker at this point.

10           And I guess what I want to say last to you, Mr.  
11 Chairman, but also to Commissioner Apgar, but especially to  
12 the Chairman, I think that you have done a great job of  
13 directing this Board. Obviously, everyone thinks of you as  
14 a very smart person, and also most people would say that you  
15 have pointed the Federal Home Loan Bank System in the right  
16 way to more mission related and less nonmission related, but  
17 I think that this is a case where what you're doing in  
18 mission is directly contradictory to what we're trying to do  
19 in capital, and it does for me raise safety-and-soundness  
20 concerns. So I hope that you would agree with me to strike  
21 core-mission activities. And I also want to thank both of  
22 you for letting me go through my speech without  
23 interruption, and I'm happy now for your comments.

24           CHAIRMAN MORRISON: Okay. So you move the  
25 amendment to strike the CMA provision of the rule, is that

1 correct? The portion of 940.

2 MR. O'NEILL: Yeah.

3 CHAIRMAN MORRISON: Okay.

4 MR. O'NEILL: And not do anything to either  
5 acquired member assets, advances, or investments.

6 CHAIRMAN MORRISON: I don't have the votes to  
7 talk, so I should shut up, but that is hard for me to do,  
8 this being my last Board meeting.

9 As a matter of personal privilege, I have to say  
10 that I don't really think those people who did not write the  
11 letter are really in a position to say what the spirit of  
12 the letter was because the letter is not at all spiritual;  
13 it is quite direct and specific about what is promised and  
14 what is not. And while many have tried, including from the  
15 moment it was written in the legislative history and beyond,  
16 to engraft onto the letter promises not contained, it was  
17 written with great care and great consultation, including  
18 with people outside of the Finance Board, to be quite clear  
19 about what was and was not being promised.

20 So with all due respect to Senator Gramm, I really  
21 don't think he or you or others can quite engraft a spirit  
22 onto it that wasn't in the heart and the mind of the  
23 drafter.

24 In any case, we have taken a very specific step in  
25 what is presented to the Board to send a signal about what

1 we are and are not doing with this enactment. Thinking we  
2 were doing something nice, we incorporated a grandfather  
3 provision regarding existing NBS holdings and other such  
4 assets, and by including it, whether it was just a good  
5 arguing point or whether it was deeply felt by those outside  
6 the Finance Board, that by including it we were dropping the  
7 first shoe of preparation, dropping the second shoe of  
8 reinstating the proposal that we had an FMMA for specific  
9 percentages.

10           And so we've removed that to say as strongly as  
11 it's possible to say that the real hope here is that by  
12 saying up front that there are some things that are higher  
13 value added to the public interest than others, that the  
14 Board in the future will never have to write a set of  
15 percentages because the natural commitment of the Banks and  
16 their members to try to both advance their economic  
17 interests and the public interest will come together in a  
18 successful outcome.

19           So whoever it is out there that thinks that this  
20 is just a stalking horse for the return of FMMA should think  
21 again and think it is, in fact, an offer by the Finance  
22 Board to those about to write capital plans to think about  
23 how you can have both, good economics and good public  
24 policy, and I think they are not at all at war with one  
25 another.

1           Secondly, with respect to the ability to sell  
2 Class B stock, there is a lot of loose talk about the return  
3 on the stock of this System, but today the stock, the Class  
4 A stock paying interest rates as low as five, five and a  
5 half or so and as high as close to eight percent as nominal  
6 interest rates, nominal dividend rates, is actually as a  
7 return on equity to the members because of the way they can  
8 leverage their investment and the way they can borrow funds  
9 either from depositors or the Federal Home Loan Banks to  
10 finance those are returns at least in the teens and  
11 stretching up well above that into the twenties, thirties  
12 forties, and above, depending on how you rate the leverage.

13           This is one of the best-earning assets on the  
14 books of the members of the Federal Home Loan Banks today,  
15 and we know that empirically from when there has been  
16 resistance to the redemption of these shares, and in a  
17 new-capital model where Class A stock has lower risk than  
18 our current stock has because it will stand behind retained  
19 earnings and Class B stock and can be paid a lower return  
20 and still be an appropriate return on the essentially  
21 debt-like risk to an AAA that it will represent, Class stock  
22 B offers to the members of this System with no enhancement  
23 of profitability from where we are today. A return that is  
24 truly spectacular with respect to the equity of the member.  
25       And that is because members of the Bank System, as

1 regulated financial institutions, generally cannot invest in  
2 equities, and this is an equity return that's going to be  
3 available to them, and it's going to look awfully good if  
4 they just do this arithmetic.

5           And I don't know whether it's because it's in  
6 everybody's interest to talk down the dividend or because  
7 people have never done these calculations, but it's one of  
8 the great hidden secrets of this System, and it took me four  
9 years of rooting around and a little assist from Fannie Mae  
10 to actually bring this to the surface. And Fannie Mae has  
11 misused this leverage to suggest somehow that the capital of  
12 the Bank System is inadequate, and they are wrong about that  
13 because this is paid-in capital, and it doesn't matter how  
14 it's leveraged outside. It's not leveraged to be in the  
15 capital of the Banks.

16           But they have made this point, and they are  
17 correct, that the return, the equity return, is quite  
18 attractive now, and there is no reason that anyone should  
19 not want to hold Class B stock. It is a terrific  
20 opportunity, and it can be the best-returning asset on the  
21 books of most of the members. And so the worry about this  
22 is either misunderstood and misplaced or this is just a  
23 debate where people are using symbols that aren't quite what  
24 they appear. I don't know which it is, but this is  
25 something that's really quite important for everybody to

1 recognize.

2           There is nothing in this enactment that would  
3 reduce the profitability of a Federal Home Loan Bank in any  
4 way, shape, or form. There is in this overall enactment the  
5 opportunity for the Federal Home Loan Banks to be more  
6 profitable. That's the bottom line.

7           Finally, with respect to the timing, and I agree  
8 completely with Mr. Apgar about this, you can argue whether  
9 to do it now or do it later, but I know to a moral certainty  
10 that all of the people to a one who are saying today don't  
11 do it now until we do the capital, if that were the outcome,  
12 would be here next summer saying to the Board, don't do it  
13 now, we've done the capital, and we can't have this  
14 intrusion on the decisions that we've made.

15           So it's okay to be against ever doing it. That's  
16 a natural, regulated-entity point of view about many rules.

17           But to do it later, that dog won't hunt. The fact is that  
18 if there are normative judgments to be made, and as we are  
19 also doing, which Mr. O'Neill is perfectly in support of, we  
20 are expanding the capacity of the Bank to do certain things,  
21 the capital plans have to reflect the business that's going  
22 to be done, and hiding the ball or delaying the decision is  
23 not going to make it any easier for the Banks to get the  
24 capital right. And, frankly, you know, that is what J.P.  
25 Morgan said to us when we talked to them. They said, no, we

1 would rather have no restrictions on the investments.

2 That's the position of the Banks: No  
3 restrictions, the fewest restrictions, even implied  
4 restrictions, even normative judgments, we would rather have  
5 it. They were clear about that. That's clearly the  
6 position of the Banks. All regulated entities feel that  
7 way.

8 But when asked the question whether certainty was  
9 important if there were going to be such judgments, it's  
10 clearly now. So voting no makes sense if you don't believe  
11 in the restriction, and voting yes makes sense, but  
12 deferring on that, the members of Congress, Senator Gramm,  
13 with all due respect, have got it backwards.

14 And so, you know, we should say yes or no, that's  
15 what you offer us in your amendment. It's perfectly  
16 appropriate. It's not for later; it's for now or probably  
17 never. And for me, after five years of trying to make it  
18 now, I hope it's now. Anything further?

19 The vote occurs on the amendment by Mr. O'Neill.  
20 All in favor please say aye.

21 MR. O'NEILL: AYE.

22 CHAIRMAN MORRISON: Opposed, no.

23 MR. APGAR: No.

24 CHAIRMAN MORRISON: No. The no's have it. Then  
25 it's not agreed to. Good.

1           Okay. Mr. O'Neill, do you have another amendment,  
2 or is that?

3           MR. O'NEILL: The other amendment could be offered  
4 either place.

5           CHAIRMAN MORRISON: The whole thing is open.

6           MR. O'NEILL: What I'm saying is my second  
7 amendment could be either on this or on the second item.

8           CHAIRMAN MORRISON: Okay. You're going to hold  
9 it? All right.

10          MR. O'NEILL: Yeah.

11          CHAIRMAN MORRISON: Okay. Just one latest comment  
12 before we vote on this overall rule. The AMA provisions  
13 here, and in a sense we've had huge amounts of debate about  
14 the part of this rule that has absolutely no legislative  
15 effect. It is essentially a guidance to the Boards in doing  
16 their own planning.

17                 We've had relatively little discussion about the  
18 details of what I hope may well turn out to be one of the  
19 most important decisions that have ever been made in  
20 creating a third way of the management of mortgage assets  
21 and setting the Federal Home Loan Banks on only their second  
22 major product opportunity in almost seven years. It remains  
23 to be seen whether other pieces will fall in place in the  
24 marketplace and in the regulatory schemes for capital, but  
25 the AMA provision here essentially says to the Federal Home

1 Loan Banks, create a recourse structural alternative to our  
2 current secondary market for housing loans and seek to make  
3 that effective not only in the narrow, conforming  
4 marketplace that currently exists, but broadly across the  
5 various kinds of assets that Federal Home Loan Banks have  
6 been or will be allowed to take as collateral and see  
7 whether the resource idea, if properly capitalized, can, in  
8 fact, become a better economic model for more competitive  
9 pricing and greater availability of lending for housing and  
10 for economic-development activities.

11 This is pretty substantial if it works. The only  
12 way we will find out if it works is to empower it, as we are  
13 in this rule, and to encourage the Banks to pursue it, as  
14 we, I hope, will do with the capital structure.

15 So that is really the thing that we're doing today  
16 that is of dramatic importance, and on that I think we have  
17 a broad consensus here, and I'm grateful for that. And  
18 there's lots of nooks and crannies in the details of this  
19 rule because the capital structure that are most members as  
20 financial institutions live under does not permit merely  
21 saying recourse transactions because we do that, then they  
22 get clobbered on capital, and it won't work, which is why  
23 this model has not yet been tried. So we had a lot of  
24 details, which some members of the Bank System call friction  
25 or impediments or barriers. They actually are clever

1 techniques to get around regulatory schemes that exist for  
2 other reasons in other places and that unfortunately  
3 overcapitalize transactions in the mortgage business. So  
4 our effort has been to respect those regimes and still to  
5 achieve more efficient and appropriate economic capital for  
6 these transactions.

7 I think that as these products develop and as more  
8 members have an interest in their success, that those other  
9 regulatory authorities will be responsive to changes. There  
10 are certainly proposals pending right now to make recourse  
11 capital more appropriate than it's been in the past.

12 So there is real opportunity here. It's a  
13 competitive challenge for those who dominate the secondary  
14 market now, but, frankly, if the recourse structure is  
15 changed to appropriate capitalization, they will be equally  
16 able to compete for recourse as well as nonrecourse  
17 business, and everybody will be the winner. So Federal Home  
18 Loan Banks should take their moment in the sun and run with  
19 it and get big and strong so that when the rules change and  
20 the other guys come, they will still survive.

21 So this is, I think, a very important occasion in  
22 that respect, and there will be as soon as this is passed a  
23 campaign from those who have been campaigning on this  
24 subject in various forms during the legislative process and  
25 during this rulemaking process, and they will be up on the

1 Hill during this appropriation process, and they will be  
2 arguing here that our capital rule should be delayed, and  
3 it's all part of the campaign by those people who do not  
4 want this alternative to get off the ground.

5 Nobody should be fooled about this. The next  
6 argument coming is that the Federal Home Loan Banks have  
7 inadequate capital to be engaged in this activity. That is  
8 why there is a special capital provision for special  
9 capitalization that is written into this rule, and that is  
10 why it is imperative that this Board move swiftly to the  
11 capital rule in final form on schedule and to move ahead.

12 There is always delay as an option to difficult  
13 decisions. I think this Board has overcome any inclination  
14 in that direction, but it doesn't mean that everybody out in  
15 the community feels that way. The problem is that those in  
16 good faith who would like to go a little slower should watch  
17 whose interest that actually is that he is being pursued by  
18 others.

19 And I urge my colleagues as I part, and the  
20 Federal Home Loan Banks in particular, to recognize that if  
21 they want to be in this business, they are going to come  
22 under attack for not having risk-based capital by those who  
23 are already in this marketplace, and they should want their  
24 risk-based capital yesterday rather than six years from now.

25 And I hope that that will motivate people to do business

1 plans this summer and to figure out how to fit within the  
2 statute and to gallop ahead because this new capital regime  
3 is one heck of a better deal from an economic standpoint and  
4 a safety-and-soundness standpoint than anything that exists  
5 right now.

6 So, with that said, the vote occurs on the motion  
7 to approve the rule as presented to us with the two  
8 modifications. We suggest that all in favor please say aye.

9 MR. APGAR: Aye.

10 CHAIRMAN MORRISON: Opposed, no?

11 MR. O'NEILL: No.

12 CHAIRMAN MORRISON: The ayes have it, and the  
13 resolution is agreed to. I ask unanimous consent that the  
14 Board authorize the staff to make the technical and  
15 conforming changes for publication in the Federal Register  
16 and represent to my colleagues that early tomorrow afternoon  
17 will be the time in which we will have to get these done,  
18 and that the staff will work with you and your staff this  
19 afternoon and tomorrow on any changes that you would like to  
20 see in the text. Without objection, so ordered.

21 Item Number 2 on the agenda.

22 MR. GINSBERG: Mr. Chairman, members of the Board,  
23 Item Number 2 is also a final rule put forward for the  
24 Board's consideration. This final rule would fulfill an  
25 important mandate of the Congress as set forth in Gramm-

1 Leach-Bliley, which is to permit the Federal Home Loan Banks  
2 to accept as collateral for advances new categories of  
3 collateral from certain smaller members, community financial  
4 institution members of the Federal Home Loan Bank System,  
5 those new categories being small-business loans, small-farm  
6 loans, and small-agribusiness loans, as well as to accept an  
7 old category of collateral, a preexisting category of  
8 collateral, other real-estate collateral, nonmortgage  
9 collateral, from all members of the System without  
10 limitation as to amount. This final rule would, in so  
11 authorizing the Banks, would also create a new process for  
12 Banks to process to the Finance Board and for the Finance  
13 Board to review and approve new business activities by the  
14 Federal Home Loan Banks.

15 And I'm going to ask Julie Paller from the Office  
16 of Policy to present the final rule. Julie.

17 MS. PALLER: Thank you. Good afternoon, Mr.  
18 Chairman, Directors Apgar and O'Neill. Presenting today for  
19 your consideration the final rule that would amend the  
20 Finance Board advances regulation to implement certain  
21 provisions of the FHLB Modernization Act signed into law on  
22 November 12, 1999.

23 The Modernization Act amended several advance-  
24 related provisions of the Bank Act. These include the  
25 establishment of community financial institutions, or

1 "CFIs," as a new category of System member, expanding the  
2 purposes for which Federal Home Loan Banks may make  
3 long-term advances to CFIs, and allowing the Banks to accept  
4 from CFIs new categories of collateral to secure advances.  
5 The Modernization Act also removed for all members the limit  
6 on other real-estate-related collateral currently set at 30  
7 percent of member capital and removed all of the provisions  
8 related to members that are not qualified thrift lenders.

9 On May 8, 2000, the Finance Board issued a notice  
10 of proposed rulemaking that proposed amendments to the  
11 Finance Board's regulations to implement the new statutory  
12 authorities. The Finance Board received letters from a  
13 total of 64 commenters.

14 The Modernization Act amended the Bank Act to  
15 allow CFI members to pledge new types of collateral as  
16 security for specifically secured loans under small business  
17 or agriculture or securities representing a whole interest  
18 in such secured loans.

19 The proposed rule defined small-business loans,  
20 small-farm loans, and small-agribusiness loans based on the  
21 size of the loan. Small-business loans were defined as  
22 business loans with an original amount, including the  
23 aggregate of all loans to a particular borrower, of not more  
24 than \$1 million. Small-farm loans and small-agribusiness  
25 loans were to be limited to loans not greater than \$500,000.

1           In addition, business loans and farm or  
2 agribusiness loans greater than \$1 million and \$500,000,  
3 respectively, would have been considered small if the CFI  
4 could document on a case-by-case basis that the borrower  
5 meets the eligibility standard for a small-business concern  
6 under the SBA's regulations.

7           Agriculture loans were defined in the proposed  
8 rule as small-farm loans and small-agribusiness loans. The  
9 consensus among commenters was that the aggregate loan size  
10 limit set forth in the proposed definitions were too  
11 restrictive and that the alternative documentation  
12 requirements for loans above the aggregate-loan-size limits  
13 would be too time consuming and burdensome to offer a  
14 practical approach.

15           Many commenters recommended instead that the  
16 Finance Board adopt a definitional approach tied to the  
17 legal loans-to-one-borrower limits. The effective loan  
18 limit resulting from the loan-to-one-borrower approach would  
19 generally range from \$3.75 million to \$6 million for a \$500  
20 million institution, depending on the amount of capital the  
21 institution holds and other factors.

22           Staff believes that the loan-to-one-borrower  
23 approach offers advantages over the definitions of  
24 small-business, small-farm, and small-agribusiness loans set  
25 forth in the proposed rule and that it would result in

1 aggregate-loan size limits that are relative to the size of  
2 each CFI, would eliminate the need to adjust the aggregate-  
3 loan size limits over time for inflation, and would ease  
4 administration and implementation costs. Further, it does  
5 not raise any additional safety-and-soundness concerns.

6 Therefore, it is recommended that the Finance  
7 Board adopt this definition in the final rule. The proposed  
8 rule defined a community financial institution, or CFI, as  
9 an FDIC-insured institution that has as of the date of the  
10 transaction at issue less than \$500 million in average total  
11 assets based on the average total assets over the three  
12 years preceding that date.

13 A number of commenters recommended that the Banks  
14 be allowed to determine the status of their members by  
15 calculating the average total assets of their members on an  
16 annual basis based on calendar-year-end data, further  
17 stating that calculating their members' CFI status on a  
18 quarterly or monthly basis would result in administrative  
19 burdens and expense and would cause some members' CFI status  
20 to fluctuate frequently.

21 In order to reduce the administrative burden and  
22 the likelihood of frequent fluctuations, staff is  
23 recommending that the final rule require that the Banks  
24 calculate each member's CFI status on annual basis using  
25 year-end data for the three most recent calendar year ends,

1 to be effective April 1st of each year. The April 1st  
2 effective date would provide sufficient time for the Banks  
3 to use calendar-year-end data available from the regulatory  
4 financial reports.

5 The proposed rule addressed how a Bank would deal  
6 with members that lose their CFI status where the member  
7 still has advances outstanding that are secured by CFI  
8 collateral. The proposed rule would have prohibited a Bank  
9 from making new advances secured by such collateral to a  
10 member that loses its CFI status but provided that a member  
11 that loses its status and has outstanding advances secured  
12 by such collateral will not be required to repay such  
13 advances prior to the stated maturity or to provide  
14 substitute collateral based solely on its change in status.

15 The proposed rule also allowed maturing advances to be  
16 renewed for a period of six months.

17 All of the comments addressing the change in CFI  
18 status provisions supported allowing outstanding advances  
19 held by members that no longer qualify as CFIs to run to  
20 their stated maturities. Some of the commenters stated that  
21 the proposed six-month renewal period for maturing advances  
22 was not long enough, and some commenters indicated that it  
23 would be difficult to determine which advances are secured  
24 by CFI-eligible collateral and which advances are secured by  
25 other collateral.

1           Based on the comments, it is recommended that the  
2 final rule be revised to apply to members that no longer  
3 qualify as CFIs and have total advances outstanding that  
4 exceed the amount that can be fully secured by  
5 non-CFI-eligible collateral. It is recommended that the  
6 final rule provide that such advances may be renewed for up  
7 to 12 months from the date the Bank determines that a member  
8 ceases to qualify as a CFI.

9           Since the Banks will be required to calculate CFI  
10 status on annual basis effective April 1st of each year, the  
11 12-month renewal period would run from April 1st of the year  
12 a Bank determines the number no longer qualifies as a CFI to  
13 March 31st of the following year.

14           The Modernization Act expanded the purposes for  
15 which the Banks may make long-term advances to CFI members  
16 to include providing funds for small businesses, small  
17 farms, and small agribusinesses. The term "providing funds  
18 for small businesses, small farms, and small agribusinesses"  
19 was interpreted as making advances to CFIs for  
20 small-business loans, small-farm loans, and  
21 small-agribusiness loans, respectively.

22           The proposed rule maintained the current  
23 requirement that before funding an advance with a maturity  
24 greater than five years a bank shall determine that the  
25 borrowing member's level of outstanding advances with

1 original maturities greater than five years does not exceed  
2 the total book value of the member's residential-housing  
3 finance assets.

4           However, in order to implement the provision in  
5 the Modernization Act that permits CFIs to make long-term  
6 advances for the purpose providing funds for small  
7 businesses, small farms, and small agribusinesses, the  
8 proposed rule amended definition of residential housing  
9 finance assets in the advances regulation and included a  
10 definition of community lending that will apply to all  
11 Finance Board regulations to enable CFI small-business  
12 loans, small-farm loans, and small-agribusiness loans to be  
13 included in the calculation.

14           The term "community lending" in the community  
15 cash-advance regulation was changed to "targeted community  
16 lending" so that that regulation would be unaffected by this  
17 change. None of the commenters addressed these changes, and  
18 thus it is recommended that they be adopted in the final  
19 rule as proposed.

20           The Modernization Act removed the limit on other  
21 real-estate-related collateral for all members, which  
22 currently is set at 30 percent of the member's capital. The  
23 proposed rule would have implemented this change by allowing  
24 the Banks to accept such collateral from all members,  
25 provided that the collateral has a readily ascertainable

1 liquidation value and can be freely liquidated in due  
2 course, and the Bank can perfect a security interest in such  
3 collateral.

4           A substantial number of Bank commenters opposed  
5 the proposed standard on the grounds that liquidation is  
6 really difficult to measure, and, therefore, impractical as  
7 a standard. In response to the Banks' concerns, it is  
8 recommended that the collateral be required to have a  
9 readily ascertainable value, can be reliably discounted to  
10 account for liquidation and other risks, and can be  
11 liquidated in due course.

12           The standard is intended to clarify that the  
13 critical factor is the Bank's ability to reliably discount  
14 the collateral in question. The phrase "can be liquidated  
15 in due course" is intended to mean that there are no known  
16 impediments to liquidation at the time the collateral is  
17 accepted by the Bank. This change is also recommended with  
18 respect to CFI-eligible collateral.

19           The proposed rule required that at least 60 days  
20 prior to engaging in a new business activity, including  
21 accepting new categories of collateral from CFIs for the  
22 first time or total other real-estate-related collateral in  
23 an amount 25 percent greater than what the Bank had accepted  
24 in the past, a Bank must file a notice with the Finance  
25 Board, which in the case of accepting new classes of

1 collateral contains information that demonstrates that the  
2 Bank has the competency to value discount and manage the  
3 risks associated with the collateral in question.

4           Several of the commenters characterized the  
5 proposed definition of new business activity as vague or  
6 overly broad and recommended that the definition be revised  
7 to include only a new program or new product undertaking and  
8 not an expansion or a refinement of an existing line of  
9 business. It is recommended that the final rule clarify  
10 that the requirement applies only to those activities  
11 specifically listed in the definition of "new business  
12 activities."

13           In addition, several of the commenters suggested  
14 that the proposed trigger requiring notice that acceptance  
15 of other real estate-related collateral was more restrictive  
16 than necessary. It is recommended that this trigger be  
17 deleted in the final rule and that the definition of new  
18 business activity be revised to include the acceptance of  
19 any other real-estate-related collateral.

20           However, in order to expedite the Banks'  
21 acceptance of such collateral while ensuring that it is done  
22 in a safe-and-sound manner, it is recommended that the  
23 60-day period not apply to the acceptance of other real-  
24 estate collateral and that the Bank be permitted to begin  
25 accepting such collateral immediately upon receipt by the

1 Finance Board of the required notice.

2 In evaluating a Bank's notice of new collateral  
3 activities, conservative discounting of new collateral would  
4 be encouraged until the Bank gains experience in valuing  
5 such collateral.

6 Staff is also recommending that the Finance Board  
7 approve certain other changes to the advances regulation  
8 that are intended to address in regulation issues that have  
9 arisen in the late several years that were addressed either  
10 through the regulatory interpretation process or through  
11 other measures. The final rule would allow assets held by  
12 an affiliate of a member to be used to secure advances to  
13 that member provided that the collateral is pledged to  
14 secure such advances and the Bank obtains and maintains a  
15 legally enforceable security interest pursuant to which the  
16 Bank's legal rights and privileges with respect to the  
17 collateral are functionally equivalent in all material  
18 respects to those that the Bank would possess if the member  
19 were to pledge the same collateral directly.

20 The provisions in the final rule are intended to  
21 codify what is to some extent existing practice of  
22 permitting members' affiliates, which are defined as any  
23 business entity that controls, is controlled by, or is under  
24 common control with a member, to pledge eligible collateral  
25 on behalf of the member.

1           The final rule also provides for a new section to  
2 be included in Part 917, "Powers and Responsibilities of  
3 Bank Boards of Directors and Senior Management," that would  
4 set forth a Bank's Board of Directors' policy  
5 responsibilities regarding member products. This provision  
6 would require that each Bank's Board of Directors adopt a  
7 member-products policy that would combine the requirements  
8 for an advances policy from the Finance Board's advances  
9 regulation and the requirements for a standby-letter-  
10 of-credit policy from the Finance Board's standby-letter-  
11 of-credit regulation into one policy covering these and  
12 other products offered to members and associates by the  
13 Banks. The member products policy requirement also would  
14 include requirements for the Banks to address other products  
15 that the Banks may offer to members, such as acquired member  
16 assets.

17           Finally, included in the final rule are  
18 corresponding changes to the Finance Board's regulations at  
19 Part 917, Part 926, Part 952, and Part 961. We would be  
20 happy to answer any questions.

21           CHAIRMAN MORRISON: Okay. Questions? Comments?

22           MR. O'NEILL: First, the staff have done great  
23 work on this, and I salute the staff for all that. My  
24 amendment on this one is more just a naming change.

25           Until the recent bevy of rules that we have done,

1 the term for nonmembers was something like either "nonmember  
2 mortgagees" or "nonmember borrowers." And in this  
3 regulation as well as the last regulation and many more it  
4 is changed to "associates." Well, I guess it's because I'm  
5 a lawyer, so I don't like the word "associates" much. It  
6 reminds me of my former life too much. So I was thinking  
7 about something that would be more or less description  
8 deficient.

9 And so I asked the National Council for State  
10 Housing Agencies that make up the majority of the nonmember  
11 mortgagees or borrowers, and they came up with the name  
12 "Housing Partners." And I thought that Housing Partners was  
13 the perfect name because what I have always said about the  
14 Federal Home Loan Bank System is that it's the junction  
15 between banking and housing, and obviously all of the  
16 members of the System are depository institutions, either  
17 commercial banks or thrifts or credit unions, and that's all  
18 the banking side of the ledger.

19 So I thought for the nonmember borrowers the term  
20 "Housing Partners" would be the perfect thing to meld both  
21 banking and housing because to me, just as is the FHLB  
22 System is a public/private enterprise, it also is both a  
23 banking and a housing enterprise.

24 And I guess the last thing I would say is you  
25 might think that this is rather a change that would be

1 difficult to implement, but probably because of computers,  
2 you just have to put in "Housing Partners" each place that  
3 "associate" occurs in all of the different regulations that  
4 it occurs right now, so I don't think that it would be that  
5 hard to make that change. So my amendment would be to  
6 replace "associates" with the term "Housing Partners."

7           CHAIRMAN MORRISON: I hate to have our last issue  
8 be a tempest in a teapot, but for most of my tenure here we  
9 have had an uphill battle to get the Federal Home Loan Banks  
10 to interact on a more level playing field with the housing  
11 finance agencies and other nonmember, or so-called  
12 nonmember, mortgagees in the past, and we have struck down  
13 various discriminatory pricing regimes that existed, and  
14 we've pushed at Banks to make these people more accessible  
15 to each other. And there has been resistance and a feeling  
16 that these folks are privileged in the law and that they get  
17 to play without capital. And the attempt here was to stop  
18 calling them what they are not, which was nonmembers, and  
19 start calling them what they are.

20           Now, your memory from your law partnership or  
21 nonpartnership days is exactly right. The problem with the  
22 word "partner" is it attracts you from those days when being  
23 a partner was better than being an associate, but it also  
24 describes owners over those who are not owners, and I think  
25 that it would be wrong to call these people what they are

1 not, which is they are not owners, and partners are owners.

2 And, frankly, it always bothers me when I hear Fannie Mae's  
3 ads about their partners who are people they do business  
4 with but that don't share in the profits, so it's sort of a  
5 strange partnership.

6 So I don't know. It's kind of a truth-in-  
7 advertising point. So the partner thing, I'm not wedded to  
8 "associates." If your concern is about housing or some  
9 other, you know, trying to make it not seem quite so  
10 disjunctive from the purpose, I could easily accept "housing  
11 associates" or something like that as a compromise on this  
12 point and would recommend it to you, and we would get  
13 housing in, and you can keep working on the next chairman to  
14 change "associates."

15 MR. O'NEILL: Because I also don't want to make  
16 this late meeting, if this is your last meeting, end on a  
17 bad note, why don't we just split the difference and make it  
18 "Housing Associates," and call it a day?

19 CHAIRMAN MORRISON: Well, if that's all right with  
20 Mr. Apgar, we'll do that.

21 MR. APGAR: I was just going to speak in defense  
22 of Sandra Day O'Connor or Ruth Bader Ginsberg, and others.  
23 I think the word "associate" is a pretty special one, but I  
24 didn't want to enter that if it got in the way of what  
25 appears to be a grand compromise.

1           CHAIRMAN MORRISON: All right. So now Deb is  
2 rubbing her head. She is the one with the computer that has  
3 to actually do this universal search.

4           MR. APGAR: If it doesn't have search and replace,  
5 you're in some trouble.

6           CHAIRMAN MORRISON: This will be a change to this  
7 regulation. It's a technical change in all of the other  
8 representations where it is, and it will be issued as a  
9 technical change whenever it's ready. It does require  
10 notice and comment, and it's just a naming change, and they  
11 don't have to get that done by tomorrow because I'm sure  
12 whoever the next chairman is will sign it.

13          MR. O'NEILL: One last thing. I didn't say this  
14 about the first preamble because I voted against the first  
15 rule, but we just got the final preamble today, and is there  
16 any way that we can do with this one what we have done in  
17 the past, which is to look over the preamble in more detail  
18 and the three Board members sign off on it just so I can  
19 look over it a little more?

20          CHAIRMAN MORRISON: Well, ordinarily, I would say  
21 yes, but I'm concerned about we can't be sure of a quorum or  
22 anything else after a few days from now, and so I feel it my  
23 responsibility to get this thing out to be published in the  
24 Register this week. And I think I will find looking at  
25 this, because I just read it last night, that there is

1 nothing to be concerned about. If I leave this meeting and  
2 read it, you will find that this preamble is in excellent  
3 shape. It's not one that's got a lot of loose ends in it.  
4 It really is done.

5 MR. GINSBERG: And the changes to the one that was  
6 distributed earlier are very minimal, really technical in  
7 nature.

8 CHAIRMAN MORRISON: So I guess that's a "no."

9 Okay. The vote occurs.

10 The last thing I would say is this rule represents  
11 this Board's accomplishment since late November 12th of each  
12 and every statutory change, statutory requirement, in Gramm-  
13 Leach-Bliley other than the final capital rule, which, as  
14 you know, is proposed and we sign off tomorrow, it will be  
15 published next week, and will become the order of business  
16 of this Board, I imagine, for several months to come.

17 And so I thank my colleagues for their willingness  
18 to keep going at this pace, even it occasionally seemed like  
19 faster than they would like to go at any given moment, but I  
20 think we have set for ourselves a high standard of doing it  
21 quickly but doing it well, and I think the staff deserves a  
22 special thanks because we've run them ragged ever since we  
23 started with FMMA sometime last year, asking them to really  
24 do the policy and legal underpinnings of some fairly  
25 dramatic changes, and I think they all deserve our thanks.

1 They also deserve a rest.

2 MR. GINSBERG: Wake Eric up long enough to know he  
3 is being thanked. He hasn't slept in days.

4 CHAIRMAN MORRISON: We should bring in some  
5 reserves to run the meetings this summer on the capital plan  
6 so that they will wake up again so that they can work on it  
7 again come fall. But I want to thank them all. I want to  
8 thank you both, and I want to move that this rule be  
9 adopted, and a vote occurs on the resolution to adopt this  
10 rule. All in favor, please say aye.

11 MR. APGAR: Aye

12 MR. O'NEILL: Aye.

13 CHAIRMAN MORRISON: Opposed, no.

14 The rule is adopted, and I ask unanimous consent  
15 for only technical and minor technical changes to be made  
16 from what is before you at this point. Without objection,  
17 so ordered. And the Board is adjourned.

18 MR. GINSBERG: Mr. Chairman, if I may, you've  
19 characterized this as your last meeting, so before we  
20 adjourn, on behalf of the staff, if I could just offer a  
21 comment. We've all spent time this week attentive to  
22 Senator Gramm's letter, so I will use his metaphor of the  
23 road, the business of this Board being a road.

24 You've been chairman of this Board for over five  
25 years. It's been a long road. Therefore, by definition, I

1 wouldn't use Senator Gramm's metaphor, the troubled road. I  
2 would say this has been an important road that you have led  
3 this Board down. The guide posts have been public benefit,  
4 a benefit to the consuming public.

5           We've sought to create public benefit through  
6 promoting competition among GSEs and through finding new  
7 ways to use the cooperative structure to allocate risks and  
8 benefits and to find ways for the Federal Home Loan Banks  
9 and their government-bestowed advantages to reach  
10 underserved populations. I think everybody would agree that  
11 there is a long way to go on this road, but you've been the  
12 engineer and the architect.

13           And I know I speak for the staff in saying it's  
14 been a privilege and a pleasure to work with you on this,  
15 and we thank you very much.

16           CHAIRMAN MORRISON: Thank you very much.

17           (Applause.)

18           (Whereupon, at 3:30 p.m., the meeting was  
19 adjourned.)

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REPORTER'S CERTIFICATE

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DOCKET NO.: N/A  
CASE TITLE: FHFB Open Meeting  
HEARING DATE: June 29, 2000  
LOCATION: Washington, DC

I hereby certify that the proceedings and evidence are contained fully and accurately on the tapes and notes reported by me at the hearing in the above case before the Federal Housing Finance Board.

Date: June 29, 2000

Theodore Fambro  
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