COUNCIL of FEDERAL HOME LOAN BANKS

August 23, 2000

The Honorable Richard Baker
Chairman
House Subcommittee on Capital Markets, Securities and
Government Sponsored Enterprise
434 Cannon House Office Building
U.S. House of Representatives
Washington, DC 20515

Dear Chairman Baker:

Thank you for this opportunity to comment again on H.R. 3703, the Housing Finance Regulatory Improvement Act of 2000. In preparation for the hearing during which the Council testified in May, 2000 and in the months that have followed, we believe that we've developed an understanding with you and your staff regarding aspects of the bill that affect the Federal Home Loan Bank (FHLBanks) system. We would like to take this opportunity to reiterate that understanding and contribute to the Roundtable discussion on four important points. A similar letter is also being sent to the Subcommittee's Ranking Member, Paul Kanjorski.

As Curt Hage, Chairman of the Council and President of Home Federal in South Dakota, noted in his oral testimony before your committee in May (copy attached), the "super lien" is an important business tool for FHLBanks. Removing it would neither advance the safety and soundness of the FHLBanks nor benefit consumers. In fact, repeal would significantly raise costs to the FHLBanks, the member institutions we serve and, ultimately, consumers by requiring the FHLBanks to perfect each and every loan used as collateral. In our discussions with you and your staff, you have apparently concurred with this assessment and agreed not to insert the "super lien" language into a redraft of the bill.

Another equally important issue is maintaining the Treasury's line of credit. As Congress evaluates the concerns surrounding GSEs and their debt, it will be critical to remember that the FHLBanks are one of the few AAA-rated financial institutions in the world. Moreover, the FHLBanks are jointly and severally liable, meaning that the 12 FHLBanks are responsible for one another in addition to themselves. This combination of stellar credit and joint liability means that risks to the government from the FHLBanks are very low; nonetheless, maintaining the Treasury line of credit is an important component of our GSE status. Consequently, we have asked your staff to appropriately weigh the FHLBank debt and risk situation when H.R. 3703 is redrafted.

In our discussions with you, we have also talked about the need for the FHLBanks to maintain investment flexibility. One of the great changes made in the financial modernization bill, driven by your leadership, was to expand the FHLBank mission to include community lending - - small business loans, small farm and agri-business loans. This change will help strengthen local economies. But the success of this change is contingent on having the flexibility to react to shifting local economic situations and bank member needs. This requires the use of a number of management tools, including the ability to invest in mortgage-backed securities. For that reason, we ask that your bill reflect the need for the FHLBanks to maintain investment discretion while fulfilling their mission and allow us continued flexibility in managing our balance sheets in all economic situations.

Finally, we would like to extend our thanks. Without the leadership of you and Congressman Kanjorski, the Federal Home Loan Bank System Modernization Act of 1999 (FHLB Act) and the improvements it has brought to the FHLBank system never would have happened. While we recognize that it is the right and responsibility of Congress to determine the best and most effective regulatory structure for the GSEs, we believe that changing our regulatory structure at this time would only complicate an already complicated situation. We are currently involved in construction and implementation of a new capital plan, as directed in the FHLB Act. It is one of the most important and difficult challenges our system has ever faced and involves the coordination of numerous intricate tasks with numerous players. Thus, without debating the merits of a regulatory merger in general, the Council feels that at this time, implementation of the FHLB Act will be done sooner, and in a more seamless manner, if our current regulatory structure is left in place.

This outline, in a nutshell, presents the understanding we reached with your staff. The key points are spelled out in greater detail in the attachments to this letter. We trust that you concur and that this understanding will be reflected in upcoming changes to H.R. 3703.

As always, we are eager and available to discuss these or other matters involving the FHLBanks with you. We appreciate your thoughtful attention to our concerns and this opportunity to provide our input.

Sincerely,

John von Seggern
President and CEO

Attachments