OPENING STATEMENT OF
RANKING DEMOCRATIC MEMBER PAUL E. KANJORSKI

SUBCOMMITTEE ON CAPITAL MARKETS, INSURANCE, AND GOVERNMENT SPONSORED ENTERPRISES

HEARING TO REVIEW THE FEDERAL HOME LOAN BANK SYSTEM

THURSDAY, SEPTEMBER 7, 2006

Mr. Chairman, we meet this morning to once again examine the Federal Home Loan Bank System. As you already know, I share your deep interest in these important financial institutions. After all, we worked closely together for several years to include language to improve the system during our lengthy deliberations over H.R. 10, the landmark law to modernize the financial services industry.

Perhaps most importantly, our joint efforts in 1999 resulted in a much-needed update of the capital structure at each of the Federal Home Loan Banks. Until we acted on these matters, these financial institutions had operated under antiquated subscription capital rules created 67 years earlier in 1932.

Specifically, the law now requires each Federal Home Loan Bank to submit a plan to the Federal Housing Finance Board for approval that is "best suited for the condition and operation of the bank and the interests of [its] members." Since we completed our legislative work, all but one of the Federal Home Loan Banks have received approval from the Finance Board to put in place a revised capital structure.

A regulatory proposal put forward earlier this year by the Finance Board, however, now threatens to slow the progress being made to implement these statutorily required capital reforms. Specifically, this proposal would impose inflexible minimum retained earnings levels at each bank.

This proposal has generated an extensive policy debate. Ultimately, the Finance Board received 1,066 letters on its rulemaking plan. Less than one half of one percent of commenters, as I understand, supported the regulatory change.

Some of the key arguments raised against the plan include that it could result in a decision to engage in higher-risk activities and could undermine the housing mission of the system. Standard and Poor's has also observed that the proposal may "reduce the financial flexibility" of a bank to mange its capital positions and lessen the attractiveness of membership in the system.

While I share these apprehensions, I am most concerned about the failure of the Finance Board to conform this regulatory proposal to the specific capital statutory requirements outlined in H.R. 10. This plan would impose a uniform retained earnings requirement that every bank must adopt regardless of its preferences. While law mentions retained earnings as one source of capital, it does not mandate that a bank hold a specific minimum level. In fact, as I noted in my remarks on the conference report on H.R. 10, our goal was to create "a flexible capital structure."

In a recent letter sent to Chairman Oxley and Ranking Member Frank, today's witness suggests that the Finance Board's proposed capital revisions "satisfies the intent" of H.R. 10. As an author of these provisions, I must take exception to this conclusion.

Our intent in updating the capital standards used at each of the banks was not only to create a more permanent capital system, but also to provide maximum flexibility to each of the banks to develop their own capital structures to address their own special needs. Because the retained earnings proposal decreases such flexibility, it is inconsistent with the language of the law and legislative history.

In my floor statement on H.R. 10, I also noted that I had worked to ensure that we "would not place small financial institutions at a competitive disadvantage." This regulatory proposal, in my view, would undercut our hard work to achieve that important objective.

A study by the Stanford Washington Research Group found that the proposal would disproportionately affect smaller, publicly traded financial institutions. These entities would not only experience decreases in dividend income during the transition period, but unlike large financial institutions they would also be unable to tap into our capital markets via other financing mechanisms.

Beyond my strong reservations about this recent rulemaking proposal, I continue to be very concerned about the failure of the Finance Board to follow the clear statutory mandate regarding the appointment of public interest directors. Section 7 of the Federal Home Loan Bank Act indicates that at least six directors on each bank board "shall be appointed" by the regulator. As you know Mr. Chairman, I have a very strong interest in ensuring that the Federal Home Loan Banks benefit from an independent, public voice on their boards.

Inexplicably, at least 70 percent of the public interest director positions are currently vacant. If the Finance Board fails to act on these matters by the end of the year, there will be no public interest directors at any Federal Home Loan Bank and 40 percent of all board positions will be vacant.

These vacancies occur at a time when the system is addressing increasingly complex issues. They also create corporate governance problems in terms of the workload of the remaining elected directors, institutional memory of boards, and ensuring that Federal Home Loan Banks adhere to the system's missions to promote affordable housing and advance economic development.

In closing, Mr. Chairman, I have deep reservations about the retained earnings rulemaking as proposed by the Finance Board. I also have great apprehensions about the continued failure of the Finance Board to appoint public interest directors. I therefore hope that our witness today will forthrightly inform us about what he is doing to resolve these problems.