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April 21, 2006

Mr. Ronald Rosenfeld, Chairman
Federal Housing Finance Board
1625 Eye Street, NW
Washington, DC 20006

Re: Federal Housing Finance Board.
Proposed Rule: Excess Stock
Restrictions and Retained Earnings
Requirements for the Federal Home
Loan Banks. RIN Number 3069-AB30
Docket Number 2006-03

Dear Chairman Rosenfeld:

The proposal to reduce dividends from the various Federal Home Loan Banks (Banks) to member financial institutions appears to be a government agency "fix" to treat the symptom rather than an effort to directly address the cause. The potential doubling of the Banks' equity levels strongly indicates a problem or potential for a problem.

Yes, the dividend reduction will significantly hurt our earnings. That's a given. If we, as a public company, cut our dividend, there would be outrage from our shareholders. They would expect a change <u>at the company</u>, and would not settle for some easy fix by "assessing" the shareholders through a dividend reduction program.

As an owner, we expect a true fix if the system is truly broken. Does consolidation work; are twelve bank districts truly needed? When a company has earnings issues, shareholders of a public company would demand expense reduction (including compensation and benefits review), operational efficiencies, management oversight, reduction in expensive user business trips. Going out of business or liquidating is a real threat for non-performing public companies, but apparently doesn't exist if a FHLB doesn't meet expectations.

Now we must wait 5 years (with notice) to redeem our excess stock. We are captive owners.

My frustration arises from my sense that the attached American Banker article does not indicate how the Finance Board intends to fix the system, if it is truly broken. The last paragraph indicates that "we are going to protect the system..." This is too government-like as a solution; tap someone else's deep pockets without truly addressing the underlying issues.

Your consideration of also attacking the root causes of the problems would make the reduction of dividends much more palatable.

Best regards,

N.B. Back in the late 90's the "Banks" marketed putable advances with a callable agency arbitrage. Some of us did not fully realize the significant potential loss behind this product. Over 60 Bank members have taken major accounting losses to unwind these transactions. Were the Banks serving the best interests of its shareholders when they created and marketed this product? In my opinion, it does not seem so. Again, a systemic problem?

Enclosure

Necessities: "The earnings volatility introduced by certain accounting practices also intensifies the need" to retain prudent levels of earnings, Rosenfeld says.

Making the Long-Term Case

Finance Board chief: Plan protects FHLBs

■ BY PATRICK RUCKER

WASHINGTON — The head of the Federal Housing Finance Board defended his agency's plan to significantly raise retained earnings at the Federal Home Loan banks, saying it was in the long-term interest of member banks and thrifts.

Ronald Rosenfeld acknowledged Tuesday that under the proposal — which would require the Home Loan banks to cut dividends in half until they boost their retained earnings — community banks could experience a short-term loss in dividend income. But he said the proposal is critical for protecting Home Loan bank stability in the long run.

"Any businessperson has a visceral reaction — if it's going to reduce my near-term dividends, gee, I'm opposed to it," Mr. Rosenfeld said after speaking at a conference sponsored by America's Community Bankers. "But I think that, by and large, thoughtful people can see that we all benefit from this Home Loan Bank System. It is an enormous benefit" to member banks. "Given that situation, they will be very, very respectful that the system remains strong."

Mr. Rosenfeld pointed to the unique capital structure of the Home Loan Bank System, where the majority of capital is held in stock that is fixed at $100 par value and is redeemable by member institutions. If the Home Loan banks do not hold enough in retained earnings to cushion against losses, they could be forced to dip into their stock capital — and effectively reduce the par value.

Doing so would have serious repercussions at member institutions, Mr. Rosenfeld said in his speech.

"If the value of your bank's capital stock were to be impaired, how willing would you be to take out new advances if you had to pay par for stock that would be redeemed for a lesser amount? How would your quarterly financial statements be affected?" Mr. Rosenfeld said in his speech. "I believe we have a shared interest in strengthening the capital structure of the Federal Home Loan banks."

The proposal, which was released last week, would restrict the amount of excess stock a Home Loan bank could hold and require each one to hold at least $50 million plus 1% of nonadvance assets in retained earnings.

The Home Loan banks would be required to hold approximately $4.4 billion in retained earnings — a 76% increase from the level at yearend.

Mr. Rosenfeld said the proposal was sparked by losses at the New York Home Loan Bank three years ago and enforcement actions taken against the Chicago and Seattle banks in 2004. The New York bank took a $190 million loss on manufactured-housing bonds, which nearly exhausted the bank's retained earnings.

The Finance Board cited the Chicago and Seattle banks' risk management, internal audit, capital management, and accounting processes in their enforcement actions.

"Our intent in issuing the proposal is very simple — to prevent the recurrence of conditions that gave rise to [the] need for formal enforcement action against the Seattle and Chicago Federal Home Loan banks and examination findings in other banks," Mr. Rosenfeld said.

"The earnings volatility introduced by certain accounting practices also intensifies the need for the banks to set aside prudent levels of retained earnings and do all they can to minimize the probability of dipping into the par value of their capital stock."

But some industry representatives are not yet convinced. Several community bankers at the conference said they were skeptical of the need for more retained earnings so soon after the Finance Board ordered the banks to raise them in August 2003. At that time, the agency urged the banks to pad reserves but did not set specific levels.

"No one has told us how much is going to be enough," said William White, the president of Dearborn Federal Savings Bank in Michigan. "We went through one round with the increase in retained earnings and we thought it was settled. Now it is happening all over again."

Mr. White also said the proposal — which would have a considerable impact on Home Loan banks with large mortgage portfolios — appeared to be the Finance Board's attempt to curb such programs.

"It seems that is being discouraged," he said. "That bothers me greatly. We have skin in the game. The largest asset on my books is my investment in the Federal Home Loan bank, and I should have a say in how that is operated."

Mr. Rosenfeld has denied any such intent.

Other bankers questioned the Finance Board's retained-earnings formula.

"Fifty million is a number out of the air," said Mark Macomber, the president of Litchfield Bancorp. in Connecticut. "I guess it's a 'whoops' if something happens."

Mr. Rosenfeld said he hoped bankers would weigh in during the 120-day comment period, and emphasized that the proposal was not set in stone.

"We are not geniuses, but we are going to protect the system and, with their help, create the best capital structure that we can," he said. ■