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July 10, 2006

Ronald A. Rosenfeld, Chairman  
Federal Housing Finance Board  
1625 Eye St., N.W.  
Washington, D.C. 20006

ATTENTION: Public Comments

**Re: Federal Housing Finance Board; Proposed Rule: Excess Stock Restrictions and Retained Earnings; RIN Number 3069-AB30; Docket Number 2006-03**

Dear Mr. Rosenfeld:

Cascade Bank is a long-standing shareholder in the Federal Home Loan Bank of Seattle and a member of Washington Bankers' Association. Our institution is dependent on the Seattle Bank for funding and liquidity, as well as for other financial products and services it provides, including its affordable housing and community investment products.

We believe that the Federal Housing Finance Board's proposed rule on retained earnings and excess stock will be inimical to the Bank System and members if it is adopted.

Our institution cannot support adoption of the proposed retained earnings requirement for the following reasons:

1. *The rule proposed is unnecessary to ensure the safety and soundness of the Bank System.*

The Finance Board's current capital regulations assure that district banks are adequately capitalized, especially in light of the low level of risk inherent in the advances program and low levels of other risk as managed by the System's Financial Management Policies. Further, as you are well aware, as the System's safety and soundness regulator, the Finance Board has wide ranging powers within existing law and regulation to assure that the capital levels remain adequate at the district banks. To that extent, all FHLB capital protects against bondholders (and the U.S. Treasury) against losses. As we are well aware, the Board is effectively using that authority with its current capital agreement with the Seattle Bank.

If there was ever any doubt about the loss absorbing characteristics of FHLB capital stock, it was removed when Congress enacted the Gramm-Leach-Bliley Act in 1999. That legislation explicitly defined permanent capital as Class B stock and retained earnings without giving preference to one over the other.

Despite some missteps by individual FHLBs, there has been no instance where the capital adequacy of the district bank was ever in question. Certainly, the capital adequacy of the System has never been in question. So there was never concern expressed in the investment community about the financial integrity of the System or even any individual district bank.

The rating agencies and the capital markets properly regard all capital as loss-absorbing, and the proportion of retained earnings to capital stock held by an FHLB is irrelevant to their assessment of the adequacy of an FHLB capital position. The Seattle Bank is well capitalized and is rated Aaa by Moody's and AA+ by Standard and Poor's.

The proposed rule, the Finance Board seems to presume that retained earnings are a superior form of capital than direct investment in FHLB stock.

2. *All FHLBank capital comes from its shareholders, and the proposed rule, if adopted, will certainly result in an economic loss to FHLBank shareholders.*

It is estimated that the proposed rule, if adopted, will require the FHLBs to increase retained earnings by approximately \$3 billion. Because a district bank's ability to pay dividends to its shareholders will be reduced by an equal amount until the retained earnings limit is met, the proposed rule would effectively impose a \$3 billion tax on the membership. We view this as a tax because the retained earnings balance will never be returned to the shareholders.

Under the terms of the proposed rule, the economic loss to FHLB shareholders would be even greater than the par value of the stock because the present value of the current dividends foregone is greater than the value of the loss which may be suffered at a later date. Because FHLB stock is purchased and redeemed at par value, and because there is no secondary market for this stock, there is no potential for appreciation in its value. The only economic income generated by the stock is the present value of current and future dividends.

Simply stated, if retained earnings are built to high levels, current dividends are reduced and can only be recovered in the remote case of a district bank liquidation.

3. *The proposed rule, if adopted, will reduce the amount of liquidity within the Bank System.*

Under the proposed rule, the FHLBanks will be required to hold the same amount of capital to support cash and short-term, highly rated securities as they do to support assets with greater risk. It will be too expensive for the FHLBanks to maintain anything over and above the minimum liquidity amount. That, in turn, will affect the availability of liquidity for the FHLBanks' member institutions. Such an approach is inconsistent with the risk based capital rules applied to other financial institutions.

4. *The proposed rule is unnecessary to protect shareholders' investments in the FHLBanks.*

The Finance Board argues that the proposed rule is necessary to protect the par value of our investment in the Seattle Bank. We do not view our investment in the Seattle Bank as "risk free," nor do our regulators, as is evidenced by the risk-based capital charge assigned to FHLB stock. We believe and acknowledge that the value of our Seattle Bank stock is not guaranteed and that the purpose of the stock is to provide a cushion against future losses.

5. *The proposed rule heightens concerns among FHLB shareholders that their retained earnings may be confiscated at some future date.*

Even though the Gramm-Leach-Bliley Act of 1999 conferred legal ownership of retained earnings to Class B shareholders, FHLB retained earnings have been confiscated twice in the past. There is no assurance that this type of event will not occur again.

6. *The proposed rule inappropriately assigns a one-size-fits-all formula to the individual FHLBanks.*

A fundamental flaw of the proposed rule is its one-size-fits-all application of an arbitrary formula to all FHLB. We strongly urge the Finance Board to continue its policy of allowing each FHLB's Board of Directors to establish an appropriate retained earnings policy for its institution and the members they represent. The safety and soundness of each FHLB's policy can and should continue to be function of the examination process.

For these reasons, we strongly encourage the Finance Board to withdraw the proposed regulation and reissue it as an Advance Notice of Proposed Rulemaking to ensure that all relevant issues are properly vetted prior to the issuance of a new regulation.

Sincerely,



Carol K. Nelson  
President and CEO  
Cascade Bank

cc: James E. Gilleran, President & CEO, Federal Home Loan Bank of Seattle  
James M. Pishue, President & CEO, Washington Bankers Association  
U.S. Senator Maria Cantwell  
U.S. Senator Patty Murray  
U.S. Representative Rick Larsen