



OSU Federal
Your Community Credit Union™

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

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

Dear Mr. Rosenfeld:

OSU Federal Credit Union is a shareholder in the Federal Home Loan Bank of Seattle. Our institution relies on the Seattle Bank for liquidity and funding, as well as its affordable housing and community investment products.

We are very concerned about the Federal Housing Finance Board's proposed rule on retained earnings and excess stock. We believe that the proposed rule, while intended to ensure the safety and soundness of the Federal Home Loan Bank System, will have unintended consequences that will significantly harm the Bank System if it is adopted.

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

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

It is estimated that the proposed rule, if adopted, will require the FHLBs to increase retained earnings by approximately \$3 billion. In particular, the FHLB of Seattle would have to increase its retained earnings over 400%. Because an FHLB'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 banking industry. We view this as a tax because the retained earnings balance will never be returned to the shareholders. Moreover, if an FHLB's retained earnings were required to cover a loss, its shareholders would have to replenish the retained earnings pool, once again at the expense of their dividends.

The Finance Board may argue that, in the event of a loss, the retained earnings would ensure that the par value of the stock is maintained. However, this argument ignores the fact that even though the accounting value of the stock is maintained, the stockholders would still lose this part of their investment.

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.

If retained earnings are built to the very high levels proposed, current dividends are reduced and can only be recovered in the remote case of an FHLB liquidation.

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

Under the proposed rule, the FHLBs 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. Because it will be too costly for the FHLBs to maintain anything over and above the minimum liquidity amount, this adversely affect the availability of liquidity for the FHLBs' member institutions.

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

When Congress passed the Gramm-Leach-Bliley Act in 1999, it defined permanent capital as Class B stock and retained earnings, without giving preference to one over the other. As such, all FHLB capital protects against losses. Yet, with this proposed rule, the Finance Board seems to presume that retained earnings are a superior form of capital to FHLB stock.

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 unrelated to their assessment of the adequacy of an FHLB's capital position.

The Seattle Bank is well capitalized and is rated Aaa by Moody's and AA+ by Standard and Poor's.

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

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 would create inequity among FHLB shareholders.*

Although existing FHLB shareholders would be responsible for generating additional retained earnings (at the expense of any dividends), new shareholders will also have legal claim to any future distribution of retained earnings generated by the foregone contributions of the existing shareholders. Because FHLB stock is currently redeemed, by statute at par value, the distribution of earnings on a current basis, in the form of dividends, effectively eliminates this type of inequity.

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

A fundamental flaw of the proposed rule is its one-size-fits-all application of an arbitrary formula to all FHLBs. 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 a 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,

Jennifer Humcke
Assistant Vice President of Finance