Massachusetts Bankers Association

July 13, 2006

Federal Housing Finance Board
Attention: Public Comments
1625 Eye Street, NW
Washington, DC 20006

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

To Whom It May Concern:

On behalf of our 210 commercial, savings, cooperative, and savings and loan members throughout Massachusetts and New England, the Massachusetts Bankers Association (MBA) appreciates the opportunity to comment on the Federal Housing Finance Board's (Finance Board) proposed rule on Excess Stock Restrictions and Retained Earnings Requirements for the Federal Home Loan Banks. We support the Finance Board's goal of ensuring the safety and soundness of the Federal Home Loan Bank (FHLBank) System. However, we are extremely concerned that the proposed rule will have a significant negative impact on banks in Massachusetts, affordable housing, and the entire Federal Home Loan Bank System.

While we believe the proposed rule is unnecessary and should be withdrawn, if the Finance Board decides to move forward, substantial revisions should be made and additional comments sought before a final rule is issued. Should you continue to pursue such aggressive capital requirements, we have included a number of suggested changes in our comments.

Retained Earnings Should Reflect Varied Risk Characteristics of FHLBanks

As you know, each FHLBank is different, varying greatly in asset size, business plans, markets, and risk profile. It is unfortunate that the proposed rule does not recognize the diversity among the twelve member banks, and instead places a "one-size-fits-all" retained earnings mandate that does not reflect the complexity of the system. The proposed rule essentially ignores risk as a factor in determining what level of retained earnings each bank should hold.

We believe the Finance Board should focus on creating retained earnings policies for each Bank that take into consideration each institution's size and risk profile. This would mirror the Board's prior approach to retained earnings plans that was the focus of an Advisory Bulletin issued in August 2003. The Bulletin directed each FHLBank to perform annual risk assessments to determine the adequacy of its retained earnings.

The FHLBank of Boston, working closely with the Finance Board, conducted a robust analysis of its risk profile. The Bank's Board of Directors subsequently adopted a strong retained earnings policy that accurately reflects the risk profile of the institution. The Finance Board approved this policy. This is far preferable to the "one-size-fits-all" approach contained in the proposed rule. If the Finance Board decides to move forward with a single formula for all twelve banks, we believe that at least the $50 million figure should be eliminated and replaced with a system where there is varying risk weighting for larger and smaller FHLBanks.

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Extend Time Period for Compliance

The proposed rule requires each FHLBank to limit dividend payments to no more than 50 percent of net earnings until the FHLBank reaches the $50 million retained earnings requirement. This requirement will needlessly increase the cost of borrowing, causing some members to stop or curtail borrowing from the FHLBanks. If these borrowers leave the system, the loss of advances and drop in net income would only further delay compliance with the retained earnings minimum requirement, thus defeating the purpose of the proposed rule.

As you know, the FHLBank of Boston has built significant retained earnings recently – more than tripling its retained earnings level in the last three years. This has been done with a measured approach that has allowed the Boston Bank to maintain realistic, yet somewhat lower dividends for its members during the process. We encourage the Finance Board to consider other approaches, like that of the Boston Bank, which will not increase the cost of borrowing for FHLBank member institutions.

If the Finance Board does decide to move forward with this portion of the rule, we believe that it should be modified to permit the FHLBanks to increase the percentage of net income they may pay in dividends while allowing a longer period to achieve the retained earning minimum. We propose authorizing the FHLBanks to pay a higher percentage of their net earnings in dividends – perhaps 80 percent. In addition, we believe a seven- to ten-year phase-in of any new requirements would be appropriate. These modifications to the proposed rule would still satisfy safety and soundness objectives without threatening the FHLBanks, their members, and ultimately consumers.

Impact on FHLBank Members

We are particularly concerned that the proposed rule will have a substantial and disproportionate adverse impact on smaller, community banks that are FHLBank members. Unlike large institutions, which are able to obtain funding from the capital markets and other investors, community banks are not able to cost-effectively tap these liquidity sources and rely on the FHLBanks as an important funding source.

As we noted, if dividends are reduced and the cost of borrowing increases, larger institutions may eliminate FHLBank borrowing altogether, further increasing borrowing costs for community banks. Particularly during the current interest rate cycle, which has placed severe pressure on bank deposits, we urge the Finance Board to study the potential impact of the proposed rule carefully and determine the potential impact on community banks. Ultimately, increased borrowing costs could put many of these institutions at a significant competitive disadvantage while reducing mortgage options for consumers.

Limitations on Excess Stock

Perhaps the most confusing provision of this proposal is prohibiting the sale of excess stock to member banks and imposing an overall cap on the amount of excess stock outstanding at an FHLBank to one percent of the Bank's assets. We understand that the Finance Board may be using this proposal to limit FHLBank acquisition of certain assets, however we believe the Board should address this issue directly.

As bank regulators continue to move ahead with risk-based Basel IA and Basel II capital accords, it seems contradictory for the Finance Board to abandon this concept. Risk-based standards provide a "pay-to-play" option to mitigate risks not only to the individual participating banks, but also to the FHLBank System as a whole. We strongly believe the Finance Board should reconsider this option.

Impact on Affordable Housing and Community Development

As you may know, the lack of affordable housing is a critical issue in Massachusetts. Many of our member banks are active in promoting affordable housing and other community development activities through their participation in the FHLBank of Boston's Affordable Housing Program (AHP) and through the utilization of advances from the Community Development Advance (CDA) and New England Fund (NEF) programs.

Because the AHP and other community development programs rely on a portion of the FHLBank's earnings for funding, a potential decrease in advances that could occur due to higher borrowing costs and the corresponding decrease in net income could result in substantially less funding being available for these programs. We strongly urge the Finance Board to analyze the impact of the proposed rule on these community development and affordable housing programs.

Conclusion

Our member banks are committed to maintaining a strong FHLBank System. However, we believe the proposed rule could potentially do considerable harm to the system, its members, and ultimately consumers. We urge the Finance Board to withdraw the rule and issue an Advanced Notice of Proposed Rulemaking to encourage a dialog among all interested parties before issuing a new proposal. We believe the changes we have suggested will fulfill the Board's safety and soundness mission while lessening the negative impact on the FHLBank system.

Thank you again for the opportunity to comment on the proposed rule. If you have any questions or need additional information, please contact me at (617) 523-7595.

Sincerely,

Jon K. Skarin
Director,
Federal Regulatory & Legislative Policy

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