

July 7, 2006

Federal Housing Finance Board
1625 Eye Street, N.W.
Washington, DC 20006

Attention: Public Comments

RE: Federal Housing Finance Board Proposed Rule #2006-03

Dear Members of the Board:

On behalf of Capitol National Bank, I support the premise that all Federal Home Loan Banks should operate in a safe and sound manner and be adequately capitalized based on their individual risk profiles. The maintenance of a financially strong Federal Home Loan Bank System is critical to our industry, our housing market, and our economy.

Federal Home Loan Bank advances are a vital source of funding for Capitol National Bank and other Michigan banks. Funding from the FHLBank of Indianapolis is a critical part of our overall funding and balance sheet strategy.

I believe the requirements outlined in the Finance Board's proposed rule #2006-03 on retained earnings and capital stock requirements for FHLBanks will have significant unintended consequences that could negatively affect the way FHLBank of Indianapolis provides funding and services to Capitol National Bank and other Michigan banks. My concerns in that regard are outlined below:

Availability of funding: I believe the proposed rule would reduce the availability of FHLBank advances which are a vital, cost effective, and readily available source of funding. Any reduction in the capacity of the FHLBanks to fund advances would be detrimental to Capitol National Bank and the banking industry in Michigan as well as the continued economic development of the communities served. This could seriously and adversely impact a state that is already suffering economically.

Negative Dividend Impact: FHLBank dividends are significant to our institutions. Dividends effectively reduce the cost of the FHLB advances and make this source of funding more cost effective. To the extent that the dividends paid by the FHLBanks are reduced as a result of the retained earnings provisions of the proposed rule, this will increase the cost of this funding for Michigan banking institutions.

The Retained Earnings Requirements portion of the capital proposal, while simple to calculate and applied consistently to all FHLBanks, is neither fair nor equitable. This “one-size-fits-all” approach, as currently drafted, would require retained earnings to be held against all “non-advance assets”, including low risk assets such as cash and overnight federal funds. This approach effectively penalizes a FHLB with a lower risk asset profile, while rewarding an FHLB with a more risky asset profile.

In summary, while Capitol National Bank supports the goal and mission of the Federal Housing Finance Board to assure that the FHLB System is financially sound, I suggest that the Finance Board withdraw the proposed regulation, and reissue an Advanced Notice of Proposed Rulemaking.

If the Finance Board does not withdraw the proposal, I urge the following changes:

Retained Earnings Formula. The retained earnings requirement for non-advance assets (Cash, Federal Funds, Mortgage-Backed Securities and Acquired Member Assets) should be risk-based to reflect the difference in market and credit risk of the assets, similar to the manner used in financial institution capital standards.

- Transition Period. A specific deadline should be established for each FHLBank to achieve its retained earnings minimum. During this transition period, each FHLBank should be permitted to continue to set its own dividend policies without restriction, so long as the FHLBank remains on course to meet its required retained earnings minimum target by the deadline.

I hope you will diligently consider the seriousness of the concerns expressed and either withdraw the current proposal, or modify the proposal to address these concerns before adoption is considered.

Sincerely,



John C. Smythe
President & CEO

Cc: Diane Bissell
Michigan Bankers Association