THE ANNAPOLIS BANKING AND TRUST COMPANY

Robert E. Henel, Jr.
President & CEO

July 10, 2006

BY EMAIL AND U.S. MAIL

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

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

Ladies and Gentlemen:

On behalf of Annapolis Bank & Trust Company we thank you for the opportunity to comment on the proposed rule changes governing minimum levels of retained earnings, the amount of excess capital stock outstanding and the amount and timing of dividend payments from Federal Home Loan Banks (FHLBanks). We appreciate the efforts that the Federal Housing Finance Board (Finance Board) is making to ensure that the Federal Home Loan Bank System (FHLB System) remains financially safe and sound and is able to grow and attract new members.

As a member of the Federal Home Loan Bank of Atlanta (FHLBA), we are extremely aware of the role that the level of capital plays in the riskiness of our stock investment. We view FHLBA stock as an asset that carries measurable risk of financial loss. Clearly however, we perceive that the benefits in the form of stock dividends; access to liquidity, unique funding structures, access to affordable housing programs and other products and services offered by the FHLBA make the "return" on this investment favorable when compared to the risk. We believe that the proposed rule changes would unfavorably alter this risk/reward trade-off and negatively impact FHLBanks' ability to grow and accomplish their public policy mission.

1) Proposed changes to Retained Earnings requirements

Role of Capital – The role of capital is to protect the organization's depositors and lenders from unexpected operating losses. The proposed minimum level of retained earnings seems to imply that only retained earnings are available to absorb losses. Certainly investors purchasing FHLBank debt securities do not take this view. From a debt investor's perspective, there is no difference between the paid-in capital that members are required to invest and retained earnings. As stated previously, we view our investment in FHLBA stock as a risk asset and have made our decision to become a member on that basis. We do not view the level of retained earnings as having a meaningful impact on the overall risk/reward equation. Of course, we view the likelihood that our investment in FHLBA stock will become impaired as extremely low. However, this is not due to the amount of retained earnings ready to absorb losses "ahead" of our capital position, but rather based upon the relatively low risk business model of the FHLBA and its risk management practices.

Retained Earnings Rule – The proposed minimum level of retained earnings proposed in § 934.2(b) does indeed "provide a straight forward, consistent and predictable means to establish minimum retained earnings requirements across the Banks.", however, this approach does not consider size differences among the various FHLBanks. The $50 million component of the calculation is arbitrary and would have a much larger impact on small FHLBanks than on large ones. In our view the fixed $50 million requirement should be removed altogether or at the very least scaled to the size of each FHLBank.

The calculation of 1% of non-advance assets is also problematic. The calculation makes no allowance for the relative riskiness of assets. Most of the non-advance assets of FHLBA are investment securities, Fed Funds Sold and interest bearing deposits – all assets of high credit quality. As written, the 1% rule would provide incentive to FHLBanks to substitute riskier assets for less risky one with no change in the amount of capital required. We believe that capital requirement needs to take into account the unique profile of each FHLBank. Each has a unique asset composition, geographic/economic environment, interest rate risk profile and operating practices. Therefore, what is needed is a risk-based framework for determining the level of overall capital not a narrowly focused rule for retained earnings.

2) Proposed changes to Dividend rules

Dividend Restriction – The proposed rule restricts each FHLBank from paying out more than 50% of net earnings as a dividend until reaching the prescribed minimum level of retained earnings. FHLBanks typically pay out high dividend/earnings ratios because their members are leveraged financial institutions that have to borrow funds in the market in order to purchase FHLBank stock. To the extent that dividend payout rates are below a member's marginal cost of funds (usually the Fed Funds rate), then holding the stock becomes dilutive to the member's earnings. The bargain that was made when most banks decided to become members of their respective FHLBanks was that dividend income from the stock would be accretive to earnings and thereby lower the cost of advances. This bargain is now being jeopardized by the proposed dividend restriction. As a member bank, we would prefer to take a distribution in the form of a dividend rather than to let retained earning build at our FHLBank as protection from some extremely low probability event or for the benefit of some future member.

At a minimum, we would like to see the dividend restriction implemented over time, so that FHLBanks can both build their level of retained earnings and meet the economic bargain that they have implicitly made with their members. A five year horizon should be sufficient time to accomplish this for most FHLBanks.

Dividend Timing – The FHLBA's current dividend practice is to declare a dividend at the end of each calendar quarter based upon the actual net income from the first two months of that quarter and the last month of the previous quarter. As drafted, the current dividend rule would delay the dividend by as much as a month because it requires the calculation of retained earnings on the basis of a full calendar quarter. We believe the current rule should be modified to allow dividends to be calculated and paid based on results that do not necessarily align with calendar quarters.

Again, we appreciate the opportunity to offer our perspective on the proposed changes and we also thank you for your consideration of these comments.

Sincerely,

RE Henel, Jr.

Robert E. Henel, Jr.
President
Annapolis Bank and Trust Company

Cc: Federal Home Loan Bank of Atlanta
Kathleen Murphy, President and CEO, MBA