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SAVINGS BANK

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FINANCE BOARD
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July 10, 2006

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

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

Greetings:

Thank you for the opportunity to comment on the Federal Housing Finance Board's proposed rule on excess stock restrictions and retained earnings requirements for the Federal Home Loan Banks. I am the Chairman and CEO of Harleysville Savings Bank, which is a stockholder and member of the Federal Home Loan Bank of Pittsburgh. I also serve as member of the board of directors of the Federal Home Loan Bank of Pittsburgh.

In my judgment, it would be wise for the Finance Board to withdraw the proposal and issue an Advance Notice of Proposed Rulemaking in order to provide a more complete discussion of the numerous issues raised by this proposal. If enacted this proposal would likely have major adverse consequences for the System, its members and our community, including the Affordable Housing program.

I am strongly opposed to the proposed rule.

I do, however, support the Finance Board in its efforts to ensure a safe and sound Federal Home Loan Bank System. While I agree that some retained earnings are an essential component of capital for the Federal Home Loan Banks, I oppose the retained earnings requirements as set forth in the proposal because it does not treat each Federal Home Loan Bank fairly and equitably based on the fact that each bank differs in not only size but also in its risk components.

The proposal also fails to recognize that Class B stock is permanent capital as provided by Congress and that other forms of capital may be available to protect against impairment and to maintain par value of member stock.

Each FHLB has already been asked by the Finance Board to determine the amount of retained earnings that may be appropriate for each Bank. The one Bank that I am familiar with, the

Federal Home Loan Bank of Pittsburgh, has been through a thoughtful and deliberate process in order to determine what it considers to be an adequate level of retained earnings and Pittsburgh currently exceeds that level.

The formula contained in the proposal will require many of the Federal Home Loan Banks to limit their dividend payouts to fifty per cent of earnings, depriving its stockholders and members of a valuable source of income and discouraging many members (especially larger members) from borrowing. The results are obvious as to the effect it will have on local economies as lending is curtailed.

At the very minimum, if the Finance Board proceeds with this proposal, the retained earnings proposal must be phased in over AT LEAST A FIVE YEAR TIME PERIOD. There is a very solid basis for a five year time period. As you are aware, Class B stock is considered to be permanent capital and has a five year horizon as far as mandatory redemption is concerned.

Which brings up the question of what happens when retained earnings falls below the required level at some future date. Your proposal indicates that a Federal Home Loan Bank would be prohibited from paying any dividends if this happens. This obviously is not a wise solution and would create unintended consequences for both the Federal Home Loan Banks and its member institutions. The wide fluctuations that can take place because of various accounting rules such as FAS 133, (which are essentially timing-differences and not necessarily economic reality at any given point in time) may create temporary situations that will affect retained earnings levels adversely. Therefore, my judgment would tell me that the five year horizon is not only logical but should always apply in every circumstance whether it is the initial time period or any subsequent period triggered by a Bank dropping below the required retained earnings level. A practical approach would be to limit the payment of dividends to no more than 80% of earnings without Finance Board approval, when retained earnings levels drop below required levels.

The proposal discusses at various times the question of paying dividends only on a quarterly calendar basis. I can understand the concept of paying dividends on income earned only, but I am opposed to specifically limiting the payment of dividends to calendar quarters in that the timing could cause Federal Home Loan Bank stockholders to actually miss one full quarter's dividend.

I am also opposed to the proposal that restricts "excess stock" and the payment of dividends in stock form. Since this proposal would require the Banks to use their earnings to redeem excess stock, it would make it more difficult to build retained earnings. Prohibiting stock dividends would eliminate an important tax benefit through the ability to hold these dividends on a tax-deferred basis. Mandating the redemption of excess stock creates a taxable event for the member and removes the flexibility that excess stock provides a Federal Home Loan Bank in managing its business affairs and growth.

Thank you again for giving me a chance to comment on this proposal. As a community financial institution, the Federal Home Loan Banks System has been and will continue to be an indispensable tool for Harleysville Savings Bank. The ability to take down term and amortizing advances from the Federal Home Loan Bank of Pittsburgh to match the loans that we grant to our customers is essential for our institution to continue to serve our communities.

Sincerely

Edward J. Molnar
Chairman and Chief Executive Officer