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June 30, 2006

Federal Housing Finance Board
1625 Eye Street, NW
Washington, DC 20006

Re: FHFB Proposed Rule; RIN No. 3069-AB30; Docket No. 2006-03

The California Bankers Association appreciates the opportunity to provide comments on the proposal by the Federal Housing Finance Board ("Board") on excess stock restrictions, stock dividends and retained earnings requirements ("Proposal"). CBA is a professional non-profit organization established in 1891 and represents most of the depository financial institutions in the state of California. CBA regularly issues comment letters on proposals that significantly affect our member institutions. Many CBA members rely on the Federal Home Loan Bank ("FHLBank") system as an important source of funding for their lending activities and as a source of short term liquidity. We are concerned that the Proposal would impair the benefits of FHLBank membership by restricting outstanding FHLBank stocks, prohibiting stock dividends and imposing a rigid, non risk-based restriction on retained earnings. For the reasons discussed below, CBA asks that the Board withdraw the Proposal and issue an Advance Notice of Proposed Rulemaking as a means to elicit a broad discussion of the important issues raised in the Proposal.

The Proposal's Impact on FHLBanks

The Proposal in the main includes two key elements: (i) the aggregate amount of excess stock that could be outstanding at a FHLBank would be limited to one percent of the FHLBank's total assets, in conjunction with which stock dividends would be prohibited; and (ii) each FHLBank would be required to maintain retained earnings of \$50 million plus one percent of its non-advance assets. While CBA's comments are focused on the Proposal's effect on financial institutions, we concur with comments provided by the major national bank trade associations (including the American Bankers Association and America's Community Bankers) and the comments by the individual FHLBanks regarding the Proposal's potential effects on the FHLBank system and the members.

Limiting the amount of an FHLBank's outstanding excess stock is apparently intended to moderate the risk to FHLBanks in the event of unexpected member stock redemption requests. Meeting such redemption requests could, among other things, disrupt an FHLBank's ability to support long term investments. However, Congress fully addressed this issue when it amended the Federal Home Loan Bank Act as part of the Gramm-Leach-Bliley Act ("GLBA"). Section 1426(f) of the FHLBank Act now prohibits any FHLBank from redeeming member stock if

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doing so would leave the FHLBank undercapitalized. The GLBA also required the FHLBanks to develop capital plans, which the FHLBanks developed with considerable resources, and which have been approved by the Board. This Proposal is substantially inconsistent with the Board's own capital regulations and FHLBank capital plans.

Further, Congress intended to give the FHLBanks adequate time to manage balance sheet risks when responding to redemption requests, by prohibiting the redemption of excess Class B stock prior to the end of a five year period. The Board has not explained why it believes this Congressionally-created mechanism is inadequate. In contrast, the Proposal could force FHLBanks to repurchase excess stock over the one percent limit within 60 days, thus risking the kind of instability that the GLBA was intended to prevent.

The retained earnings requirement in the Proposal is even more troubling because the proposed minimum of \$50 million plus one percent of non-advance assets bears no apparent relation to risk. The Proposal is intended to provide a cushion to absorb losses. Because FHLBanks would likely be subject to higher capital requirements than a risk-generated approach would require, their liquidity would be unnecessarily reduced, which in turn hampers their ability to provide appropriately priced advances and other services to members and support affordable housing activities. The proposal seems even less sustainable when realized that the high amounts of retained earnings being proposed are on top of, in the case of the FHLBank of San Francisco, over \$9 billion of actual capital and is intended not to protect against insolvency, but against the possibility of a charge against capital.

The Proposal's Impact to Members of FHLBanks

This leads directly to the detrimental effects the Proposal would have on member financial institutions. While some large institutions rely on FHLB advances for standby liquidity and to fund lending activities, the Proposal would disproportionately affect small- and mid-sized FHLBank members. Dividends on FHLBank stock act as an offset against the cost of advances. Arbitrarily increasing retained earnings will reduce dividends and thus increase the cost of advances, make smaller institutions less competitive and ultimately increase the cost of homeownership.

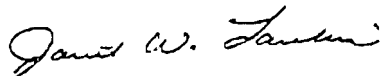
Unlike larger institutions, smaller institutions have access to relatively fewer sources of funding. Therefore, any increase in the cost of FHLB advances in the form of reduced dividends and the need to build up FHLBanks' retained earnings is likely to make smaller institutions less competitive. This is particularly applicable to mortgage lending, which is by nature a national market. By contrast, large institutions may well conclude the effective increase in the cost of advances, precipitated by the reduction in dividends, would make membership in an FHLBank unattractive. If large members significantly reduce FHLBank activity, the size of FHLBank bonds could shrink, the rate at which the bonds are issued could increase, there will be fewer large institutions to help pay the costs of an FHLBank's overhead, and the cost of advances to small members with no funding alternatives could increase.

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FHLBank members also value FHLBank stock dividends, in contrast to cash dividends, as a lawful tax planning tool. By prohibiting the distribution of stock dividends, the Proposal would lower the risk-adjusted, after-tax return on FHLBank stock, thus diminishing the value of FHLBank membership. Ironically, the Proposal itself may thus foment the kind of mass redemption that the excess stock restriction is supposed to ameliorate.

The Board has not adequately articulated the reasons the Proposal in its present form is necessary, and we believe the Board has received comments from many others indicating potentially detrimental and long-term consequences to the Federal Home Loan Bank System if the Proposal were adopted. The health and viability of the system is of vital importance to CBA members. Therefore, CBA urges that the Board withdraw its Proposal and proceed with an Advance Notice of Proposed Rulemaking.

Sincerely,



Janet W. Lamkin
President & CEO
California Bankers Association