



Ronald A. Rosenfeld
 Chairman
 Federal Housing Finance Board
 1625 Eye St., NW
 Washington, DC 20006
 ATTENTION: Public Comments

Re: Federal Housing Finance Board; Proposed Rule: Excess Stock Restrictions and Retained Earnings; RIN Number 3069-AB30; Docket Number 2006-03

Dear Mr. Rosenfeld:

Citizens Community Bank is a shareholder in the Federal Home Loan Bank of Seattle and a member of Idaho Bankers Association. Our institution relies on the Seattle Bank for liquidity and funding, as well as for other financial products and services it provides, including its affordable housing and community investment products.

We are deeply concerned about the Federal Housing Finance Board’s proposed rule on retained earnings and excess stock. We believe that the proposed rule, while intended to ensure the safety and soundness of the Federal Home Loan Bank System, will have unintended consequences that will irrevocably harm the Bank System if it is adopted.

Our institution cannot support adoption of the proposed retained earnings requirement for the following reasons:

1. *All FHLBank capital comes from its shareholders, and the proposed rule, if adopted, will certainly result in an economic loss to FHLBank shareholders.*

It is estimated that the proposed rule, if adopted, will require the FHLBanks to increase retained earnings by approximately \$3 billion. Because an FHLBank’s ability to pay dividends to its shareholders will be reduced by an equal amount until the retained earning limit is met, the proposed rule would effectively impose a \$3 billion tax on the banking industry. We view this as a tax because the retained earnings balance will never be returned to the shareholders. Moreover, if an FHLBank’s retained earnings were required to cover a loss, its shareholders would have to replenish the retained earnings pool – once again at the expense of their dividends.

The Finance Board would presumably argue that, in the event of a loss, the retained earnings would ensure that the par value of the stock is maintained. This argument, however, ignores

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the fact that, even though the accounting value of the stock is maintained, the stockholders would still lose this part of their investment.

Under the terms of the proposed rule, the economic loss to FHLBank shareholders would be even greater than the par value of the stock because the present value of the current dividends foregone is greater than the value of the loss which may be suffered at a later date. Because FHLBank stock is purchased and redeemed at par value, and because there is no secondary market for this stock, there is no potential for appreciation in its value. The only economic income generated by the stock is the present value of current and future dividends.

Simply stated, if retained earnings are built to high levels, current dividends are reduced and can only be recovered in the remote case of an FHLBank liquidation.

2. The proposed rule, if adopted, will reduce the amount of liquidity within the Bank System.

Under the proposed rule, the FHLBanks will be required to hold the same amount of capital to support cash and short-term, highly rated securities as they do to support assets with greater risk. It will be too expensive for the FHLBanks to maintain anything over and above the minimum liquidity amount. That, in turn, will affect the availability of liquidity for the FHLBanks' member institutions.

3. The rule proposed is unnecessary to ensure the safety and soundness of the Bank System.

When Congress passed the Gramm-Leach-Bliley Act in 1999, it defined permanent capital as Class B stock and retained earnings without giving preference to one over the other. As such, all FHLBank capital protects against losses. With this proposed rule, the Finance Board seems to presume that retained earnings are a superior form of capital to FHLBank stock.

Further, the rating agencies and the capital markets properly regard all capital as loss-absorbing, and the proportion of retained earnings to capital stock held by an FHLBank is irrelevant to their assessment of the adequacy of an FHLBank's capital position.

The Seattle Bank is well capitalized and is rated Aaa by Moody's and AA+ by Standard and Poor's.

4. The proposed rule is unnecessary to protect shareholders' investments in the FHLBanks.

The Finance Board argues that the proposed rule is necessary to protect the par value of our investment in the Seattle Bank. We do not view our investment in the Seattle Bank as "risk free," nor do our regulators, as is evidenced by the risk-based capital charge assigned to

FHLBank stock. We believe and acknowledge that the value of our Seattle Bank stock is not guaranteed and that the purpose of the stock is to provide a cushion against future losses.

5. The proposed rule, if adopted, will create intergenerational inequity among FHLBank shareholders.

Although existing FHLBank shareholders would be responsible for generating additional retained earnings (at the expense of any dividends), new shareholders will also have legal claim to any future distribution of retained earnings generated by the foregone contributions of the existing shareholders. Because FHLBank stock is redeemed, by statute, at par value, the distribution of earnings on a current basis in the form of dividends effectively eliminates this type of intergenerational inequity.

6. The proposed rule heightens concerns among FHLBank shareholders that their retained earnings may be confiscated at some future date.

Even though the Gramm-Leach-Bliley Act of 1999 conferred legal ownership of retained earnings to Class B shareholders, FHLBank retained earnings have been confiscated twice in the past, and there is no assurance that this type of event will not occur again.

7. The proposed rule inappropriately assigns a one-size-fits-all formula to the individual FHLBanks.

A fundamental flaw of the proposed rule is its one-size-fits-all application of an arbitrary formula to all FHLBanks. We strongly urge the Finance Board to continue its policy of allowing each FHLBank's Board of Directors to establish an appropriate retained earnings policy for its institution and the members they represent. The safety and soundness of each FHLBank's policy can and should continue to be a function of the examination process.

For those reasons, we strongly encourage the Finance Board to withdraw the proposed regulation and reissue it as an Advance Notice of Proposed Rulemaking to ensure that all relevant issues are properly vetted prior to the issuance of a new regulation.

Sincerely,

Marty Doncouse
SR VP & Real Estate Manager

cc: James E. Gilleran, President & CEO, Federal Home Loan Bank of Seattle
Dawn Justice, President Idaho Bankers Association
Senator Larry Craig
Senator Butch Otter
Congressman Butch Otter
Congressman Mike Simpson