CBAO
Community Bankers Association of Ohio
Increasing the Value of Independent Financial Institutions Since 1974

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June 23, 2006

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

Attention: Public Comments

To Whom It May Concern:

The Community Bankers Association of Ohio (CBAO) appreciates the opportunity to comment on the proposed rule published March 15, 2006 that would change the capital structure of the Federal Home Loan Bank of Cincinnati (FHLB-Cinn) by prescribing a minimum level of retained earnings and a maximum level of excess stock that can accumulate and by prohibiting payment of dividends in the form of additional shares of FHLB-Cinn capital.

The CBAO exclusively represents Community Banks and Thrifts in Ohio who serve their communities through 1,450 locations and 18,000 employees, with more than $61 Billion in assets, $46 Billion in insured deposits and over $44 Billion in net loans.

The CBAO opposes the proposed rule for the following reasons.

1. FHLB-Cinn would need to limit dividends while further building retained earnings, reduce excess stock and pay dividends in cash rather than additional shares of stock.
2. FHLB-Cinn is a well-capitalized, conservatively managed, triple-A rated, low-risk profile institution that will be negatively affected by the "one size fits all" formulas in the proposed rule. The proposed rule does not take into account the following:

    a. The individual risk profiles of the 12 FHLBanks, which we view as a disadvantage to the FHLB-Cinn;
    b. The FHLB-Cinn's exclusive issuance of Class B stock, with a 5-year option on redemption, defined as "permanent stock" by Gramm-Leach-Bliley (GLB);

c. The nature of the cooperative capital feature of the Bank's Capital Plan; and
d. The voluntary nature of the membership base, which means that the Bank must balance cost-effective products and services with a return on the members' capital investment.

3. We believe the proposed rule will erode the value of membership in the FHLB-Cinn. It will:

   a. Put the Bank's triple-A rating with Stale Outlook credit position at risk because compliance with the regulatory mandates will result in lower liquidity, lower capital levels and lower profitability, with secondary effects of more redemption requests of excess stock, increased market risk profile, and lower Advance levels;
   b. Reduce the availability and timing of product offerings to members, including same day funding, due to the Bank's lower liquidity position;
   c. Increase members' cost of doing business with the Bank, both accessing advances and selling mortgages, because it will effectively eliminate the cooperative capital feature in the Bank's Capital Plan. The proposed rule's excess stock restriction combined with the prohibition of stock dividends will cause members to have to purchase activity stock rather than use the Bank's cooperative capital. The Bank would have to repurchase twice as much capital stock under the proposed rule than it would if the Finance Board recognized the use of cooperative stock to capitalize mission asset activity and did not consider it to be excess;
   d. Reduce dividends payable by 50% during the period needed to build retained earnings;
   e. Create a tax event for members from the excess stock repurchased by the Bank to meet the regulatory limit on excess stock;
   f. Eliminate tax deferrals on future dividends by prohibiting the Bank from paying stock dividends;
   g. Reduce members' participation in the Affordable Housing Program and current and future voluntary housing programs such as New Neighbors and American Dream Homeownership Challenge due to declining profits and retained earnings shortfall; and
   h. Ultimately weaken the country's community banking system that the U.S. government has historically supported.

4. The proposed rule violates Gramm-Leach-Bliley.
   a. GLB, in defining permanent capital and distinguishing between Class A (6 mo.) and Class B (5 yr.) stock, sufficiently provided for a period to reduce excess in a timely fashion. The proposed rule's mandatory 60-day

redemption period would not only increase the instability of the FHLB-Cinn's balance sheet to the extent that excess stock does indeed support longer term assets, but it violates the intended permanent stock feature of GLB.

   b. GLB left dividend policy in the hands of the individual FHLBank Boards, so long as the FHLB-Cinn has current and retained earnings including the ability to determine the amount, timing and form of dividends.

5. One size fits all Retained Earnings formula increases risk profile.
   a. Simplistic formula ($50m + 1% of non-mission advances) is inconsistent with methodologies currently adopted by other regulators as part of Basel II.
   b. FHLB-Cinn has established a Retained Earnings Policy based on rigorous analysis of balance sheet risk involving 14,000 different earnings simulations. As of year-end 2005, the FHLB-Cinn exceeded its policy target by $48 million. The proposed rule will require the Bank to carry 80-100% more than our policy target.

6. The FHLBank System already has sufficient and adequate regulation to address the Finance Board's stated safety and soundness concerns, and Gramm-Leach-Bliley clearly addresses the issue of adequate capital at the FHLB-Cinn level.

Some of the questions that have arisen due to the proposal are:

a. Should FHLB-Cinn be required to build retained earnings to shield member stock and if so, is the proposed minimum requirement the right formula and proposed dividend restrictions appropriate?
b. How important is the avoidance of stock impairment?
c. How important is it to maintain current dividend payout levels?
d. Will dividend limits and the potential for more volatility of dividend levels cause members of all types to leave the system or decrease usage?
e. Will members find suitable investment alternatives when stock is redeemed?
f. What are the tax implications of the stock dividend redemptions to members?
g. How will MPF/MPP programs be affected?

Based upon these concerns and questions we respectfully ask that you withdraw the proposed regulation and reissue it as an Advance Notice of Proposed Rulemaking.

Sincerely,

Robert L. Palmer
President and Chief Executive Officer

CC:
Senator Mike DeWine, George V. Voinovich
Representative: Steve Chabot, Jean Schmidt, Michael Turner, Michael G. Oxley, Paul E. Gillmor, Ted Strickland, David Hobson, John A. Boehner, Mary Kaptur, Dennis J. Kucinich, Stephanie Tubbs Jones, Patrick J. Tiberi, Sherrod Brown, Steven C. LaTourette, Deborah Pryce, Ralph Regula, Tim Ryan, Bob Ney