1. Stock dividends should not be prohibited. Stock dividends provide a tax benefit to members that should not be eliminated. Given the adoption of an appropriate limit on the amount of excess stock, there is no basis to prohibit stock dividends. If an FHLBank controls the amount of excess stock outstanding, no regulatory objective is achieved by banning stock dividends.
2. The limit on excess stock should be higher than 1 percent of assets. While the preamble to the proposed regulation provided no explanation on how the 1 percent limit was determined, 1 percent is too low. A higher limit would provide greater flexibility for the FHLBank to hold liquid assets and thereby maintain higher liquidity, increasing its ability to operate in a safe and sound manner and better serve its members' fluctuating advance needs.
3. There should be a reasonable phase-in period to meet the REM. The proposed rule would limit dividends to 50 percent of net income immediately if the REM is not met when the regulation is effective. The 50 percent limitation is too severe and restrictive and could significantly hurt a member's income. It is also unreasonable and unfair to impose a dividend restriction the day the rule becomes effective. There should be at least a three-year implementation period where dividend restrictions are not imposed if the FHLBank is making reasonable progress in meeting its REM.
4. The REM applicable to money market assets should be reduced. There is no justification for imposing the same retained earnings requirement on money market assets as is required for 30-year, fixed-rate mortgages. For example, it would not unduly complicate the rule to make the REM equal to $50 million plus ½ percent of money market assets and 1 percent of non-advance, non-money market assets.
5. Once fully implemented, there should be some flexibility before dividend restrictions are imposed. The proposed rule would impose the 50 percent limitation immediately when an FHLBank failed to meet its REM. This will effectively require an FHLBank to hold substantially more than its REM in order to prevent a violation through normal balance sheet volatility. For example, it would be preferable to impose dividend restrictions only in the event that an FHLBank falls below 90 percent of its REM in a quarter or fails to meet its REM for three consecutive quarters. Given that the current REM calculation is very conservative (relatively high level of retained earnings being required), the flexibility allowed before dividend restrictions are imposed would achieve the FHFB's objective while not being as operationally difficult for the FHLBank.
6. Clarify that dividends paid and income earned in a quarter are independent. The proposed rule imposes limits on dividends based on a percentage of income earned in a quarter. Standard corporate practice does not tie dividends to income earned in a period (except over the long term) and dividends are generally stable even though income is not. FHLBank members prefer a stable dividend policy, especially when income can be materially impacted in a single quarter by gains and losses related to SFAS 133. While the imposition of dividend restrictions requires that dividends be related to income earned in a quarter, any final rule should make clear that dividends need not be related to earnings in a certain time

period if the FHLBank is in compliance with its REM. The FHLBank need only have sufficient retained earnings to meet its REM after payment of the dividend.

As most of you are aware, the Federal Housing Finance Board (FHFB) issued a proposed regulation on excess capital stock and retained earnings on March 15, 2006. The proposed rule, if put into effect as is, would:

This proposed rule has generated more heated discussion and consternation than any other FHFB action in recent memory. On May 2, 2006, the chairs and vice-chairs of all 12 FHLBanks sent a letter to the FHFB asking that the rule be withdrawn. The FHFB is accepting comments on the proposed regulation through July 13, 2006.
Director at Frontier state bank Don Correll