

Rural Telephone Bank
Minutes of the 143rd Board Meeting
January 8, 2003

Time and Place of Meeting

The 143rd meeting of the Board of Directors (Board) of the Rural Telephone Bank (Bank) was held Friday, January 8, 2003, in Conference Room 0204 U.S. Department of Agriculture, South Building, Washington, D.C., pursuant to notice published in the Federal Register on December 26, 2002. Vice Chairperson Christine Toretti, Acting Chairperson, called the meeting to order at 9:10 a.m.

Attendants

Directors present were:	Gilbert Gozalez	Luis Luna
	Roberto Salazar	James House
	Clay Davis	Christine Toretti
	Curtis Sampson	John McAllister
	Michael Jensen	David Crothers
	Larry Sevier	John Dillard

Among others present were Governor Hilda Gay Legg and staff members Assistant Governor Roberta Purcell, Deputy Assistant Governor and Assistant Secretary Jonathan Claffey and Assistant Treasurer Kenneth Ackerman as well as Terence Brady from the Office of the General Counsel. Also present were Brad Captain, Rural Telephone Finance Cooperative, Darien Pittman, National Rural Telephone Association, Bob Smith, CoBank, and Thomas Griffin, Fairpoint Communications. In addition, Mr. John Eichner, Mr. Gary Bojes, and Mr. Craig Millis from Science Applications International Corporation (SAIC) were present.

Amendment to Bylaws

Acting Chairperson Toretti introduced the next order of business for the Board to consider a resolution to amend the Bylaws to allow for Board meetings to be conducted by electronic means. Ms. Toretti called on Assistant Governor Purcell to provide background information on the following proposed amendment:

Resolution 2003-1

RESOLVED, that Article V of the Bylaws be amended by adding new Section 5.6 to read as follows:

SEC 5.6 Meetings by Electronic Means. Meetings of the Board of Directors may be held by any electronic means, including, without limitation, telephone or any other communications equipment, provided that, during the meeting, all persons participating can clearly and promptly hear, send, and receive all messages or spoken words. Participation in such a meeting shall constitute presence at the meeting.

A motion to adopt the resolution was made by Mr. Davis and seconded by Mr. Sampson. The Board unanimously approved resolution 2003-1.

Report on Privatization Study

Acting Chairperson Toretti called on Governor Legg to introduce the next order of business regarding the Draft Privatization Study. Governor Legg led off the introduction to the presentation by SAIC by restating the original goal and objectives sought in hiring a business advisor to study issues surrounding privatization of the Rural Telephone Bank (the Bank). RUS prepared a Request for Proposal (RFP) to seek qualified entities that could provide a thorough examination of the bank and present options on the various facets that would play a vital role in the process of privatization. Specifically, taking into consideration the limited amount of funds available, the RFP sought to address the following deliverables:

- 1) An asset and liability management assessment;
- 2) A market study and outreach survey;
- 3) An organizational and operational analysis;
- 4) A legislative assessment; and
- 5) A dynamic, adaptable financial model for current and future use.

Governor Legg reminded everyone that this was a discussion of the DRAFT-final report from SAIC and strongly encouraged all members to interact, among themselves and with staff, and discuss the issues presented in this draft report. She further noted that, while the report presents options and provides specific analysis of the deliverables requested, this report is intended to be the tool, or cornerstone, from which we can continue to thoughtfully address the issue of privatization.

Each deliverable was presented separately, by SAIC, with time allotted for discussion and review:

Asset and Liability Management:

The board concurred that a strong ALM approach was critical for the Bank to survive as a privatized entity. SAIC noted that a Credit Agency Review would hinge strongly on how the Bank managed its portfolio and its risk. SAIC recommended that the Bank enter into consultation with a Credit Rating Agency at the appropriate time in developing its ALM philosophy. SAIC noted that the rating agency and capital preservation considerations will drive the cost of funds available to a private Bank, a critical component to the level of success of the Bank as a private entity.

Regulatory Report:

Of the three organizational structures originally considered – Commercial Bank, Finance Company, or Cooperative – it was noted that the Commercial Bank option was eliminated early on in the study due to onerous regulatory burdens and inconsistencies with the Bank's proposed mission. The study found that the Bank could successfully privatize as either a Finance Company or a Cooperative. No definitive decision was expressed by the Board as a whole. There was discussion regarding the control of the Bank under either type of organization. It was generally recognized that the type of entity the Bank becomes should be one which is best able to fulfill its mission. Other issues, such as tax liabilities, location, stock issuance and voting rights were also discussed.

Legislative Assessment:

The general emphasis center around the fact that the current law (the RE Act of 1936) contains many provisions that do not expire when the Class A stock is retired and therefore would inhibit the Bank from operating as a successful, viable private entity. The interest rate calculation the Bank uses to set rates on loans, for instance, if not changed, would ultimately force the Bank to lose money, since it does not account for operating costs or allow the Bank to price for risk. This also led to a discussion on the possibility of access to Treasury funds after the Bank was privatized to meet its contractual obligations that it entered into with its borrowers before privatization. It was noted that approximately \$1 billion in unadvanced obligations would be transferred to the Bank with terms that would force the Bank to advance those funds at rates possibly below its cost of capital. Other legislative issues discussed were loan purposes and the Bank's relationship to the RUS program after privatization (i.e., continuance of concurrent or supplemental lending). It was noted that the legislative assessment did not include a "legal analysis" of the laws that could impact the Bank's private operations; SAIC recommended a full legal analysis by outside counsel as part of a continuing transition effort.

Market Assessment:

The market assessment focused primarily on the size of the rural telecommunications market and what portion of that market could the private Bank serve. SAIC concluded that approximately \$4.8 billion would be invested in the coming year. They estimated that Bank loans could account for anywhere from \$200 million to \$600 million. In addition to determining market size, SAIC recommended additional market analysis, including additional shareholder input and a more in depth study to explore the Bank's position in the rural telecommunications marketplace.

Organizational Blueprint:

There was a limited discussion on the internal organizational structure of the Bank after privatization. A “typical” management and board structure was discussed with emphasis placed on obtaining highly qualified individuals that could guide the Bank to securing a successful market share. Estimates of operating expenses in the financial scenarios ranged from .75% to 1.5% of non-cash assets – which is comparable to other financial institutions operating today.

Transition Plan:

It was the consensus of all that the transition to a private entity was an extremely complex task, involving many critical steps. Of the utmost importance was the need for engagement of, primarily, Treasury and the Office of Management and Budget as the process progressed, as they will play important roles in many facets of privatization. Resources, both human and monetary, were a large concern. Given the complex nature of the transition from a Federal to private entity, considerable time and money would be needed to successfully move the Bank out from under government control and establish it as a viable future source of capital to the rural market.

SAIC concluded with a discussion of “Next Steps.” If the Board desires to move forward with privatization, they recommend:

- garner Administration support and seek funds to support transition plan;
- begin implementation of transition plan;
- develop memorandum of understanding on transition team with USDA, name a transition manager, assign personnel to team, set budget, etc.;
- perform in-depth legal review;
- develop agreements with OMB and Treasury;
- inform shareholders/stakeholders of plan;
- meet with rating agencies and financial market representatives; and
- pursue legislative changes.

At the end of the privatization report, members of the public were asked if they would like to speak for the record. Mr. Tom Griffin, of Fairpoint Communications, spoke. He stated that Fairpoint was one of the ten largest holders of stock in the Bank. Ultimately, Mr. Griffin stated that more analysis should be conducted to determine if there was a need for a privatized Bank, since there were already private lenders, the existing RUS programs, and other Federal support programs (USF, etc.). If in fact there was a need, he indicated that further consideration should be given to the type of organizational

structure the Bank would become, stating that it should be in a position to address the concerns of the existing shareholders and their equity positions. Finally, Mr. Griffin proposed that liquidation may be the best option for the Bank, if in fact there was not a need for another private, rural utilities lender.

Adjournment

Whereupon motion to adjourn was made and the meeting was adjourned at approximately 4:00 p.m.

Secretary