



Number: 2006-06
Date: April 18, 2006

FEDERAL HOUSING FINANCE BOARD

Resolution and Order Approving the Issuance of Subordinated Notes By The Federal Home Loan Bank of Chicago

WHEREAS, the Federal Housing Finance Board (Finance Board) and the Federal Home Loan Bank of Chicago (Bank or Chicago Bank) entered into a written agreement on June 30, 2004 (Written Agreement), which required the Bank, among other things, to develop a business and capital management plan, which plan the Finance Board accepted on February 10, 2005;

WHEREAS, under the terms of the accepted business and capital management plan the Chicago Bank committed to substantially reduce the amount of “excess” capital stock held by its members, *i.e.*, stock a member owns that exceeds the amount required to be owned by law or regulation, which reduction was to occur over a period of years through a managed process of redemptions and other actions, and committed to maintain a ratio of the sum of the paid in value of its capital stock plus retained earnings to its total assets of at least 5.1 percent;

WHEREAS, in the months preceding October 2005, the Chicago Bank experienced an increased pace of redemptions of excess stock, such that the net redemptions that had occurred by mid-October approximately equaled the amount of stock that the Bank had planned to redeem by the end of the calendar year, which prompted the board of directors of the Bank to discontinue redemptions of excess stock as of October 18, 2005, in order to help stabilize the Bank’s capital base and ensure that the Bank would continue to meet the needs of its members;

WHEREAS, on October 18, 2005, in order to further stabilize the Bank’s capital base, the Finance Board and the Chicago Bank amended the Written Agreement, which amendments, among other things: (i) imposed a revised minimum capital requirement, under which the Bank must maintain a ratio of capital stock plus retained earnings to total assets of 4.5 percent and an aggregate amount of outstanding capital stock of \$3,978,268,612; and (ii) required the Bank to revise its retained earnings and dividend policy, and to revise its business plan to describe the strategies it would adopt to enhance its earnings and capital structure;

WHEREAS, in December 2005, the Chicago Bank submitted to the Finance Board its retained earnings and dividend policy and revised business plan strategies, which submission: (i) proposed, as a key element, to reduce the Bank’s reliance on excess stock, in part by redeeming significant amounts of such stock over a defined time period, thereby stabilizing the capital and supporting the Bank’s conversion to the Gramm-Leach-Bliley Act (GLB Act) capital structure; and (ii) proposed the issuance of subordinated debt instruments as one means of funding the redemption of such excess stock; and

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WHEREAS, the Director of the Office of Supervision has approved the Chicago Bank's December 2005 business plan strategy to issue subordinated debt and the proposed 2006 – 2009 retained earnings and dividend policy, as amended and conveyed to the Chicago Bank on April 13, 2006.

I. Authorization to Issue Subordinated Notes

WHEREAS, on April 7, 2006, the Chicago Bank filed an application seeking Finance Board approval for a proposed issuance of \$1 billion of subordinated debt instruments (Notes), the proceeds of which (net of expenses) would be used to redeem capital stock held by institutions whose membership has terminated and to redeem excess stock held by other members of the Bank;

WHEREAS, section 2A of the Federal Home Loan Bank Act (Bank Act), 12 U.S.C. § 1422a, imposes on the Finance Board a primary duty of ensuring that the Federal Home Loan Banks (FHLBanks) operate in a financially safe and sound manner and, to the extent consistent with that primary duty, requires the Finance Board to supervise the FHLBanks and to ensure that they carry out their housing finance mission, remain adequately capitalized and able to raise funds in the capital markets;

WHEREAS, section 2B of the Bank Act, 12 U.S.C. § 1422b, authorizes the Finance Board to promulgate and enforce such regulations and orders as are necessary from time to time to carry out the provisions of the Bank Act;

WHEREAS, section 11(a) of the Bank Act, 12 U.S.C. § 1431(a), authorizes a FHLBank, subject to any applicable rules and regulations promulgated by the Finance Board, to borrow and to pay interest on its outstanding debt, and to issue debentures, bonds, or other obligations upon such terms and conditions as the Finance Board may approve;

WHEREAS, the Finance Board has adopted regulations that generally authorize a FHLBank to incur certain types of liabilities in the normal course of its business, 12 C.F.R. § 965.2, but has not adopted any rules or regulations addressing the issuance of subordinated debt instruments by a FHLBank, and no regulations otherwise limit the authority of the Finance Board to approve the issuance of subordinated debt instruments on a case-by-case basis pursuant to section 11(a) of the Bank Act;

WHEREAS, the Finance Board has determined that the circumstances relating to the proposed issuance of the Notes are unique, in that the Chicago Bank is the only Bank that has not converted to the GLB Act capital structure and is more reliant on excess stock than the other FHLBanks, and the Finance Board believes that the issuance of the Notes will enhance the safety and soundness of the Bank by stabilizing its capital structure and allowing it to move toward its planned conversion to the GLB Act capital structure;

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WHEREAS, because the Notes would be the sole obligations of the Chicago Bank, they will not be “consolidated obligations,” as that term is defined by the Finance Board’s regulations, and thus will not be subject to any rules or regulations governing the consolidated obligations, unless the Finance Board orders that such rule or regulation apply to the Notes;

WHEREAS, the regulations of the Finance Board, 12 C.F.R. § 907.2, allow the Board of Directors of the Finance Board (Board of Directors) to waive any provision, restriction, or requirement of its regulations in connection with a particular transaction or activity “if such waiver is not inconsistent with the law and does not adversely affect any substantial existing rights, upon a determination that the application of the provision, restriction or requirement would adversely affect achievement of the purposes of the Act or upon a showing of good cause”; and

WHEREAS, the Board of Directors has considered the materials submitted by the Bank in conjunction with its request for approval of the issuance of the Notes, as well as presentations from Finance Board staff analyzing the transaction, and has determined that the Bank’s request to issue such securities is a reasonable means of achieving its objective of reducing its reliance on excess stock, is likely to increase the stability of the capital structure of the Bank while the Bank moves toward its capital conversion, and is otherwise consistent with the Bank Act.

NOW, THEREFORE, IT IS RESOLVED, pursuant to the authority conferred by sections 2A, 2B, and 11(a) of the Bank Act, the Board of Directors hereby approves the issuance by the Chicago Bank of \$1,000,000,000 of the Notes, provided that the Notes shall be the sole obligation of the Chicago Bank, shall not constitute the joint and several liability of any other FHLBank, shall be junior in priority to payment of all liabilities of the Chicago Bank under any consolidated obligations on which the Chicago Bank is the primary obligor or on which it may be jointly and severally liable, and shall plainly state that they are not obligations of the United States and are not guaranteed by the United States;

IT IS FURTHER RESOLVED, that the Notes shall have a term to maturity of 10 years, shall have the other terms and conditions that are set forth in application received from the Bank, and that this resolution shall constitute an order of the Finance Board approving the terms and conditions of the Notes, as provided by Section 11(a) of the Bank Act;

IT IS FURTHER RESOLVED, that the Chicago Bank is hereby authorized to accept the proceeds from the issuance of the Notes, provided that this authorization shall be limited to the Chicago Bank and shall not be construed to permit any other FHLBank to issue any subordinated debt instruments;

IT IS FURTHER RESOLVED, that because the Finance Board has determined that the above actions are consistent with its authority under the Bank Act, do not adversely affect any substantial existing rights, and aid in ensuring that the Bank operates in a financially safe and sound manner, it hereby waives any provision of 12 C.F.R. § 965.2 that otherwise may be construed as prohibiting the Bank from incurring liabilities evidenced by the Notes; and

IT IS FURTHER RESOLVED, that until the Notes are issued, any change in: (i) the condition or future prospects of the Bank; or (ii) the terms and conditions of the Notes that, in the sole discretion of the Finance Board, would be materially adverse to the safety and soundness of the Chicago Bank or the interests of the Finance Board could be cause for the Finance Board to withdraw the authorization granted herein.

II. Regulatory Leverage Requirement

WHEREAS, the Chicago Bank currently is operating under the terms of the Written Agreement, which requires the Bank to comply with the minimum capital requirement established by that Agreement, which capital requirement currently supersedes the regulatory leverage requirement that otherwise would apply to the Bank, 12 C.F.R. § 966.3(a), because it has not yet converted to the risk-based capital structure required by the GLB Act;

WHEREAS, at such time that the Written Agreement is terminated, or is otherwise amended to remove the provisions imposing the minimum capital requirement, or is otherwise superseded, the regulatory leverage requirement imposed by 12 C.F.R. § 966.3(a) will become the binding capital constraint applicable to the Bank until it converts and comes into compliance with the leverage and risk-based capital requirements established pursuant to the GLB Act; and

WHEREAS, the Finance Board believes that the proposal submitted by the Bank to use the proceeds from the issuance of the Notes to redeem stock presents a reasonable means of stabilizing the capital structure of the Bank and allows the Bank to move forward toward conversion to the GLB Act capital structure, and the Finance Board has determined that it is appropriate to facilitate the achievement of those objectives by establishing individual capital requirements for the Chicago Bank and by granting certain regulatory approvals and waivers that take into account the unique circumstances associated with this transaction.

NOW, THEREFORE, IT IS RESOLVED, that for the period during which the Chicago Bank remains subject to a capital requirement imposed by the Written Agreement or to the leverage requirement imposed by 12 C.F.R. § 966.3(a)(1) or (a)(2), the Board of Directors hereby authorizes the Bank to include, for purposes of calculating its compliance with each of those requirements and in addition to the other items specified by those provisions, the outstanding principal amount of the Notes, subject to the limitation described immediately below;

IT IS FURTHER RESOLVED, that the amount of the Notes that the Bank may include in determining its compliance with the capital requirement imposed by the Written Agreement or by the leverage requirement of section 966.3(a)(1) or (a)(2) shall be 100 percent of the outstanding principal amount of the Notes for each of the first 5 years, commencing on the issuance of the Notes, which amount shall thereafter be reduced by 20 percentage points annually, such that during years 6 through 9 the Bank shall include 80 percent, 60 percent, 40 percent, or 20 percent of the Note principal, respectively, in those calculations and shall not include any amount of Note principal in such calculations during the tenth year;

IT IS FURTHER RESOLVED, that for purposes of determining whether the Chicago Bank is operating in compliance with the requirements of 12 U.S.C. §§ 1426(f) or 1426(h)(3), and 12 C.F.R. §§ 931.4(b) or 931.7(c), the Finance Board will apply either the capital requirement established under the Written Agreement or the leverage requirement imposed by 12 C.F.R. § 966.3(a)(1) or (a)(2), calculated as provided herein, whichever is in effect and binding on the Chicago Bank at the date that compliance is to be determined; and

IT IS FURTHER RESOLVED, that because the Board of Directors has determined that the above actions are consistent with its authority under the Bank Act, do not adversely affect any substantial existing rights, and aid in ensuring that the Bank operates in a financially safe and sound manner, it hereby waives any provision of 12 C.F.R. § 966.3 that otherwise may be construed as prohibiting the Chicago Bank from including the amounts of the Notes in determining its compliance with the Written Agreement or the leverage requirements of that section.

III. Amendment to the Written Agreement

WHEREAS, the Written Agreement, as amended on October 18, 2005, imposed on the Chicago Bank an individual minimum capital requirement under which the Bank must maintain a ratio of the sum of the paid-in value of its capital stock plus retained earnings to total assets of 4.5 percent, and an aggregate amount of capital stock equal to \$3,978,268,612; and

WHEREAS, in order to allow the Chicago Bank to use the proceeds from the Notes to redeem stock currently held by its members it is necessary to revise the terms of the minimum capital requirement to which the Bank is subject under the Written Agreement.

NOW, THEREFORE IT IS RESOLVED, that the Director of the Office of Supervision is hereby authorized and directed, effective upon the Chicago Bank's receipt of the proceeds from the issuance of the Notes, to amend the Written Agreement by revising the individual minimum capital requirement, such that the Chicago Bank shall be required to maintain a ratio of the sum of the paid-in value of its capital stock, plus retained earnings, plus the face value of the outstanding Notes to total assets of at least 4.5 percent, and to maintain an aggregate amount of outstanding capital stock plus the face value of the outstanding Notes of at least \$3,500,000,000, provided that Written Agreement shall provide that the amount of the Notes that may be included in determining the Bank's compliance with the revised capital requirement shall be reduced, after the fifth year, in the manner described in Section II of this resolution and order.

IV. Investments in Mortgage Backed Securities

WHEREAS, the Financial Management Policy for the Federal Home Loan Bank System (FMP) established a series of guidelines relating to the investment, liquidity, funding, hedging, and other practices of the FHLBanks, several of which have been superseded by regulations adopted by the Finance Board;

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WHEREAS, Section II.C.2. of the FMP permits a FHLBank to invest in certain specified types of mortgage backed securities and other asset-backed securities (MBS) up to a maximum amount equal to 300 percent of the FHLBank's capital, which provision of the FMP remains in effect for all of the FHLBanks;

WHEREAS, in order to allow it to maintain the stability of its capital base and to continue to meet its obligations to its members, the Chicago Bank has requested that it be permitted to maintain its current level of MBS investment authority subsequent to the issuance of the Notes and the redemption of stock from its members, and that the Finance Board authorize an addition to the MBS investment limit that would be based on a multiple of its outstanding Notes;

WHEREAS, the Finance Board believes that the ability to preserve the current level of permissible MBS investment authority is an important element in the Bank's overall plan to reduce its reliance on excess stock and allow the Bank to convert to the GLB Act capital structure, and that reducing the current investment authority could frustrate the Bank's ability to achieve its objectives; and

WHEREAS, the Finance Board has determined that allowing the Chicago Bank to maintain its current level of MBS investment authority would not pose any undue safety and soundness risks to the Bank.

NOW, THEREFORE, IT IS RESOLVED, that the Chicago Bank is hereby authorized to invest in any MBS that currently are permissible investments under Section II.C.2. of the FMP up to a maximum of 300 percent of the outstanding balance of the Notes, subject to the limitation described immediately below, and that such authorization shall be separate from and in addition to the authorization provided by Section II.C.2. of the FMP;

IT IS FURTHER RESOLVED, that the amount of the Notes that the Bank may include in determining its compliance with MBS investment limit authorized by this resolution shall be 100 percent of the outstanding principal amount of the Notes for each of the first 5 years, commencing on the issuance of the Notes, which amount shall thereafter be reduced by 20 percentage points annually, such that during years 6 through 9 the Bank shall include 80 percent, 60 percent, 40 percent, or 20 percent of the Note principal, respectively, in those calculations and shall not include any amount of Note principal in such calculations during the tenth year;

IT IS FURTHER RESOLVED, that the authorization provided by the second preceding paragraph shall remain in effect for however long the Chicago Bank remains subject to the leverage requirement imposed by 12 C.F.R. § 966.3(a)(1) or (a)(2), and compliance with both MBS investment limitations shall be determined as of the date of purchase of any MBS;

IT IS FURTHER RESOLVED, that the authorization in the third preceding paragraph shall not be construed to permit the Chicago Bank at any time to hold MBS in an amount in excess of 300 percent of the sum of: (i) the Bank's capital stock outstanding as of the close of business on April 18, 2006, and (ii) the Bank's retained earnings account as of the close of business on April 18, 2006.

V. Unsecured Credit Limitations

WHEREAS, the Chicago Bank is subject to certain regulatory limits on the amount of unsecured credit that it may have outstanding to any one counterparty or affiliated counterparties, which limits are based in part on the “total capital” of the Bank;

WHEREAS, the Finance Board has defined “total capital” in terms of the capital elements authorized by the GLB Act capital structure, which do not currently apply to the Chicago Bank, and has applied the unsecured credit limits to FHLBanks that have not yet converted to the GLB Act capital structure by using the FHLBank’s outstanding capital stock plus retained earnings, in lieu of the defined term; and

WHEREAS, the Finance Board has determined that, in order to facilitate the Bank’s efforts to stabilize its capital structure by redeeming excess stock, it would be appropriate to establish an unsecured credit limit for the Chicago Bank that reflects the transactions being authorized by this resolution and applies during the period that the Bank transitions to the GLB Act capital structure.

NOW, THEREFORE IT IS RESOLVED, that the Board of Directors hereby authorizes the Chicago Bank to determine its compliance with the unsecured credit limits of 12 C.F.R. § 932.9 by using, in lieu of its “total capital” as defined by section 930.1, the amount resulting from the sum of its outstanding capital stock, retained earnings, and outstanding balance of the Notes, subject to the limitation described immediately below;

IT IS FURTHER RESOLVED, that the amount of the Notes that the Bank may include in determining its compliance with unsecured credit limit authorized by this resolution shall be 100 percent of the outstanding principal amount of the Notes for each of the first 5 years, commencing on the issuance of the Notes, which amount shall thereafter be reduced by 20 percentage points annually, such that during years 6 through 9 the Bank shall include 80 percent, 60 percent, 40 percent, or 20 percent of the Note principal, respectively, in those calculations and shall not include any amount of Note principal in such calculations during the tenth year;

IT IS FURTHER RESOLVED, that the authorization provided by the second preceding paragraph shall remain in effect for however long the Chicago Bank remains subject to the leverage requirement imposed by 12 C.F.R. § 966.3(a)(1) or (a)(2); and

IT IS FURTHER RESOLVED, that because the Board of Directors has determined that the above actions are consistent with its authority under the Bank Act, do not adversely affect any substantial existing rights, and aid in ensuring that the Bank operates in a financially safe and sound manner, it hereby waives any provision of 12 C.F.R. § 932.9 that otherwise may be construed as prohibiting the Chicago Bank from including the amounts of the Notes in determining its compliance with the unsecured credit limits of that section.

VI. Delegation of Authority

WHEREAS, the Finance Board recognizes that some period of time will elapse between the date of the approval for the issuance of the Notes and the date on which the Notes are actually issued, and that it is possible that market conditions or other events may create a need for the Chicago Bank to modify some aspect of the application that has been considered and approved by the Board of Directors, and that such events may arise shortly prior to the scheduled date of issuance.

NOW, THEREFORE IT IS RESOLVED, that the Director of the Office of Supervision is hereby delegated the authority to approve any modifications to the terms and conditions of the Notes, provided, however, that the Director shall provide the Board of Directors of the Finance Board with notice of the actions he proposes to take as soon as is practicable prior to acting.

VII. Redemption Guidelines

WHEREAS, the Chicago Bank has adopted certain redemption guidelines that it proposes to use to govern the manner in which the Bank will redeem stock owned by institutions that have terminated their membership and the manner in which it will redeem excess stock owned by institutions that will continue as Bank members, and has requested that the Finance Board approve its use of the redemption guidelines; and

WHEREAS, the Finance Board has determined that the terms of the redemption guidelines are consistent with the applicable provisions of the Bank Act and will aid the Bank in managing the proposed redemptions in an orderly and equitable fashion.

NOW, THEREFORE IT IS RESOLVED, that the Director of the Office of Supervision and the General Counsel are hereby authorized and directed to approve the redemption guidelines, and shall coordinate their approval of the guidelines with the Director's approval of the amendments to the Written Agreement, as authorized by Section III. of this resolution and order.

VIII. Miscellaneous

WHEREAS, certain provisions of the regulations of the Department of the Treasury that relate to transactions in United States securities and to relief on the account of the loss, theft, or destruction of United States securities have been incorporated by the Finance Board and adopted as applying to the consolidated obligations issued by the FHLBanks, as provided in 12 C.F.R. §§ 966.5 and 966.6;

WHEREAS, other provisions of the Finance Board rules have authorized the Secretary of the Treasury to act as agent of the Finance Board in administering those incorporated provisions with respect to the consolidated obligations of the FHLBanks, and to waive those regulations, as provided in 12 C.F.R. § 966.7;

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WHEREAS, other provisions of the Finance Board rules establish requirements relating to the book-entry procedures for the consolidated obligations issued by the FHLBanks, 12 C.F.R. part 987; and

WHEREAS, the Finance Board believes that it would be appropriate to apply those same concepts and procedures to the Notes, to the extent that it is feasible to do so.

NOW, THEREFORE IT IS RESOLVED, that the Director of the Office of Supervision and the General Counsel are hereby authorized and directed to determine whether, and how, the concepts and procedures embodied in the above-cited provisions may be applied to the Notes, and to take whatever actions may be appropriate to achieve that result, including requesting the Board of Directors of the Finance Board to take further actions extending the substance of those provisions to the Notes; and

IT IS FURTHER RESOLVED, that the Board of Directors hereby authorizes the Office of Finance to act as agent for the Chicago Bank in connection with the issuance and servicing of the Notes, provided that the Bank agrees to promptly pay the Office of Finance any reasonable expenses that it incurs in connection with any actions it takes in acting as agent for the Bank with respect to the Notes, and the Director of the Office of Supervision is hereby authorized and directed to take any action on behalf of the Finance Board that is necessary to achieve that result.

IX. Effective Date

WHEREAS, the Finance Board is awaiting confirmation from the Chicago Bank that its board of directors has ratified the retained earnings and dividend policy, as amended and conveyed to the Chicago Bank on April 13, 2006.

NOW, THEREFORE IT IS RESOLVED, that the approvals, authorizations, waivers, amendments, and other actions in this resolution and order shall take effect on the date that the Director of the Office of Supervision has received confirmation to his satisfaction that the board of directors of the Chicago Bank has ratified the retained earnings and dividend policy as amended and conveyed to the Chicago Bank on April 13, 2006.

By the Board of Directors
of the Federal Housing Finance Board

/s/ Ronald A. Rosenfeld

Ronald A. Rosenfeld
Chairman