IN THE FEDERAL HOUSING FINANCE BOARD

IN THE MATTER OF:)
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OPEN MEETING)
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Board Room
Federal Housing Finance Board
1777 F Street, N.W.
Washington, D.C. 20006

Wednesday,
May 17, 2000

The parties met, pursuant to the notice, at 2:43 p.m.

BEFORE: BRUCE A. MORRISON, Chairman

APPEARANCES:

Board Members:

WILLIAM C. APGAR
J. TIMOTHY O'NEILL

Staff:
WILLIAM A. GINSBERG
JANET FRONCKOWIAK
DEBORAH F. SILBERMAN
PATRICIA SWEENEY

Presentations by:

WINTHROP WATSON
J.P. Morgan

WILLIAM LEWIS
PriceWaterhouseCoopers

P R O C E E D I N G S

(2:43 p.m.)

MR. MORRISON: The meeting will come to order. With respect to the first item on the agenda, Final Rule: Election of Federal Home Loan Bank Directors, I move that the Board of directors determine that the Finance Board business requires the removal of this agenda item, with changes made in less than seven days notice to the public and no earlier notice of these changes was possible. Without objection, so ordered. And we'll move to item two on the agenda, Designation of Federal Home Loan Bank Directors. Janet.

MS. FRONCKOWIAK: Good afternoon, Chairman Morrison and members of the Board of directors. Staff is requesting approval by the Board of directors of the Finance Board of a resolution designating the directorship of the Federal Home Loan Banks. The Bank Act requires that the Finance Board annually designate the number of Federal Home Loan Bank elected directorships for each state and each district. The number of directorships is determined by the Finance Board within certain constraints provided by the Bank Act.

Additionally, by regulation the Finance Board must complete the annual designation of directorships and notify the Banks of the results no later than June first of each year. Finance Board action to designate the directorships will allow us to fulfill our statutory and regulatory requirements.

The Bank Act also governs how directorships are allocated for each state within a district. It provides that the number of elected directors is to be determined in the approximate ratio of required stockholdings of member institutions within each state at year 1999 to the total required stockholdings of all member institutions in the district at year end 1999.

Under this stock based allocation formula, each state must be allocated at least one elective directorship, but no state is allocated more than six elected directorships. The Bank Act also includes a grandfather provision under which each state may not be allocated fewer directorships than were allocated to it as of December 31, 1960.

The Bank Act also gives the Finance Board the discretion to increase by regulation the number of elective directorships to a maximum of 13 in any district containing five or more states. The Boston, Atlanta, Des Moines, Dallas, and Seattle districts contain five or more states, thus making them eligible for discretionary seats. The Bank Act further provides that in these five districts containing five or more states, the Finance Board has the authority to increase the number of appointed directorships to a number not exceeding three-fourths the number of elective directorships. To date, only the Dallas Bank has not had its appointed directorships increased.

On November 12, 1999, the Gramm-Leach-Bliley Act became law, amending the Bank Act to establish three-year terms for all of Federal Home Loan Bank directors. The GLB Act also provides that the Finance Board and the Board of directors of each Bank shall adjust the term of any director first appointed or elected after enactment of the GLB Act, as necessary to stagger each Bank's Boards into three approximately equal classes.

At the Board meeting on February 23rd, the Finance Board approved a proposal to amend its regulation in light of the act to provide standards regarding the manner in which the Banks must stagger their Boards.

In coordination with the Banks, staff has compiled and completed the reconciliation of minimum capital stock requirements, and has applied the stock based allocation formula to arrive a the minimum required allocation of directorships. Spreadsheets contained in your Board package demonstrate how the elected directorships are allocated among the states using the stock-based allocation formula and applying the statutory grandfather provision.

Unlike in previous years, this year the minimum required allocation does not include directorships preserved by incumbency, a concept that has been proposed to be eliminated in the rulemaking to amend the election of the Federal Home Loan Bank directors regulation.

Although the final rule will not have been adopted prior to this designation of directorships, it is anticipated that the final election rule will be presented to the Board of Directors for adoption very soon. This year, applying the stock based allocation formula will yield changes in the designation of directorships for the previous year in two districts, Boston and Topeka.

In the Boston district, the stock based allocation results in the loss of Connecticut's non-guaranteed stock sheet. This year, as a result of the stock based allocation of eight seats in the district, Massachusetts gets three seats, and the remaining five states each get one seat.

Last year, both Massachusetts and Connecticut got two seats under the stock based allocation, and the remaining four states each got one seat. Additionally, Massachusetts got a third seat from the grandfather benefit under the stock based allocation for the 1999 designation of directorships. In the 2000 designation of directorships, Massachusetts does not benefit from the grandfather provision because it gets its statutory number of seats based on the stock based allocation.

However, because this district meets the five-state minimum for consideration of discretionary seats, the Board of Directors of the Finance Board has the option to change the designation of directorships for the Boston district by approving discretionary seats.

In the Topeka district, the stock based allocation results in the redesignation of Oklahoma's nonguaranteed stock seats in Nebraska. Because this district does not meet the five-state minimum for consideration of discretionary seats, the Board of Directors of the Finance Board does not have the option to change this allocation. In effect, this redesignation of directorship reduces the number of directorships allocated to Oklahoma by one and increases the number of directorships allocated to Nebraska by one.

The total number of directorships for the Topeka district will remain unchanged at ten in the 2000 designation of directorships. As part of your Board package, you will have a draft Board resolution approving the 2000 designation of directorships for your consideration.

This completes my presentation. If you have any questions, I'd be happy to answer them.

MR. MORRISON: I appreciate it. Can I have a motion to approve the resolution?

MR. O'NEILL: So moved.

MR. MORRISON: Okay. Are there any questions?

(No audible response)

MR. MORRISON: Okay. Hearing no questions, let me just for the record lay out the procedure that we are going through in the adoption of this designation and the pending proposed rule and the issue that the Banks need to decide in terms of whether to validate the 1999 elections or do the 2000 elections. First, this designation, which includes the discretionary seats as well for both elected and appointed directors, and sets the stage for all of the selections, both by the members and by this Board in the months ahead will resolve the issues of how many seats are there, from which states, and whatever.

We have reviewed the comments on the proposed regulation, and the overwhelming majority of them are both supportive and technical in nature, the technical questions and the like. And so the final rule will be presented to the Board, probably by notational vote, in the near future, and will resemble very much the proposed rule. And there are no significant policy changes that will be proposed in the form of the final rule.

When the final rule has been adopted, the decision making will shift to the Banks to make a determination as to whether or not to run any elections in the year 2000. It appears that there are no significant changes in the quota of seats for each state, so that unless there are some eligibility issues of which we are not aware, that is people who ran last year and their institution is no longer a member, or they are no longer with their institution, there is likely to be in every district, in every state the option of merely validating the election.

The Office of General Counsel will prepare a document for the Banks along this line to basically apply the rule to this choice to allow the Boards probably in June to make their judgment as to which way they want to go on this so they can move ahead. Yes.

MR. O'NEILL: I guess one question, the only place where we have more directorships than we did before, I guess, was Nebraska, which now has three rather than two.

MR. MORRISON: Well, the way things work in Nebraska under the proposed rule and what would be brought up to the Board as a final rule, when a seat moves like that, the person sitting in the seat loses eligibility. But the seat continues, and the seat's term continues as it was established in order to preserve the staggering of directors, which you are required to do under Gramm-Leach-Bliley.

So what will happen there is that the current incumbent will become ineligible at the end of this calendar year. But the seat will be then vacant, and that will be up to the Board of directors of the Federal Home Loan Bank of Topeka to fill that seat for the remainder of the term, and then the first election will occur when that term expires so that it doesn't engage in any election.

MR. O'NEILL: And the only thing that they have to do is make sure that the person that they pick is somebody from Nebraska.

MR. MORRISON: Well, he also has to be an officer or director of one of the institutions in Nebraska that is a member of the Bank. But there are a lot more people in Nebraska than that.

(Laughter)

MR. MORRISON: Okay. And so with that clarification, are there any questions? Yes.

MR. GINSBERG: One clarification for the record, Mr. Chairman. Janet spoke at length about the effect of the year end '99 stock purchase or stock holdings of the members in the Boston district, for example. But I just wanted to make sure that the Board members understand that it is in the record that the resolution that is before you that has been moved includes the approval of discretionary seats as well, including the discretionary seats in Connecticut and Massachusetts that Janet made reference to, being at the option of the Board, and in fact includes discretionary seats throughout the System.

So I just wanted to make sure that it is clear that that is in the resolution that has now been moved and it is before the Board.

MR. MORRISON: Right. And to say one other thing on that score, although in contrast to our past rule, the proposed rule permits the termination of a term of office before it is completed, that is, in the past we had these retained by incumbency situations because our rule did not allow the termination. In fact, our action today, in creation or maintenance of discretionary seats does not do that to anybody. We have the power to do it under the new rule, but we are not doing it. We are basically maintaining people to complete their terms because it is convenient to do that in all the instances where it arises.

MR. O'NEILL: And in Connecticut, which is another seat that lost one under the stock because we are putting in a discretionary seat, right now they have two, and next year they will have two.

MR. MORRISON: Right. Although they don't have a carrying over incumbent. They have another person who will have won the election if the bank chooses to validate the '99 election, or they can run the new election for the seat. Okay? Therefore, the vote occurs on the motion by Mr. O'Neill that the resolution be adopted as presented.

All in favor, please say aye.

(Chorus of ayes)

MR. MORRISON: Opposed, no. The ayes have it, and the resolution is agreed to.

MR. APGAR: Before we go to the final, I just wanted to make just one observation here. People may have noticed that sitting over in that chair, Jim Gray is no longer there. That is not Jim Gray.

MR. MORRISON: Yeah.

(Laughter)

MR. APGAR: And first of all, I just wanted to make on the record our thanks to Jim, although he couldn't be here. I think he is busy at his new job, but he really made my time here easier in transition. He served the Board well. And, of course, I am now drawing on another experienced member of the staff to help me in my role as the HUD's designated. I just wanted to, perhaps given Jim's long years of service, maybe I can impose on the Chairman to draft a joint letter from the Board thanking him for his service and wishing him well in his endeavors.

MR. MORRISON: Absolutely.

MR. APGAR: Okay.

MR. MORRISON: We'll do that immediately.

MR. APGAR: Thank you.

MR. MORRISON: We join you in thanking Jim and welcoming Diane to his seat. Okay. Let's move to item three. The Gramm-Leach-Bliley Act made a significant number of important changes in the Federal Home Loan Bank System, but none more important than the approval of a new capital structure to accommodate universal voluntary membership and to incorporate risk based governance of the amount of capital, has had not been the case heretofore.

The Congress provided for a year for the Finance Board to promulgate regulations governing this new capital structure, and the Board has been hard at work. The staff of the Board has been hard at work over the past six months in formulating those rules. And the target date for promulgation of a final rule is November 12th of 2000.

For that reason, we have scheduled a meeting next week, May 22nd, for the consideration of a proposed rule to be followed by a 90-day comment period to allow ample time to comment, but also to allow enough time for the finalization of the rule by November, and that the promulgation of a final rule in November, under the statute, will then be followed by a 90-day period. I mean a nine-month period, excuse me a nine-month period, a 270-day period, during which the Banks will formulate their actual capital plans, that is, use the regulatory structure to make their own decisions with their members about which choices to make under the rule, which will be then submitted to the

Finance Board.

The deadline there is August of 2001. And then following approval with whatever modifications may be necessary during the approval process, a beginning of up to three-year transition period for the Banks.

So while this is a very big set of changes, there is quite a long time period during which they are actually adopted and implemented. And we are essentially at the beginning of that process about to set sail next week.

In preparation for that, there have been a number of meetings between experts retained by the Federal Home Loan Banks and our staff working through some of the more challenging details of writing a regulation. And at the request of a Board member that we have an opportunity before our action next week to ask questions of those experts, we have scheduled this meeting.

In the Board book is a document prepared by J.P. Morgan, one of the consultants to the Federal Home Loan Banks on this matter. It is styled draft three, which I suppose protects everyone against any sense of finality in any of this. But, obviously, it is three, which means it itself has been subjected to a good deal of discussion. And that is the document that has been presented to the Bank Presidents and presented to us and discussed by us.

In the preparation of that document, J.P. Morgan had the benefit of two documents prepared by our staff, one of which was a narrative of principles and parameters that was followed by a more detailed outline and a somewhat modified outline that described our ideas about what a regulation might include. And it is on the basis of that discussion and analysis that Mr. Watson is here on behalf of J.P. Morgan, and Mr. Lewis is here on behalf of PriceWaterhouseCoopers to mostly to respond to questions that Board members may have. But we have invited them to make a short introductory presentation.

The thrust of what we are doing here is not to say what shall the final rule say because that is what we have a comment period about, but to answer questions or make statements about the shape of the proposed rule and whether it is consistent with the process that is about to begin of analysis that is going to go in the banks to respond to the proposed rule.

So that is where we are. Does anybody, either of my colleagues, want to say anything else in preparation?

MR. O'NEILL: No.

MR. APGAR: No.

MR. MORRISON: Okay. Mr. Watson.

MR. WATSON: Thank you, Mr. Chairman. I was going to start with a brief summary of our involvement here. Maybe I'll just, in the risk of repeating you for a minute, just go through it. We were hired in mid to late April by the 12 Federal Home Loan Banks with a narrow mission for our assignment. The assignment was to review the materials that have been put together by the FHFB in preparation for the May 22nd meeting to proposed regulations related to capital, and our assignment to review these and see whether we thought that they were consistent with the ability to have the best possible process for the Banks to raise capital.

In so doing, we developed a framework for looking at the capital process, and through that framework developed some recommendations, which we presented to the bank presidents and to the FHFB staff and to Chairman Morrison and Director O'Neill two days ago. So with that as a background, let me just give you a quick snapshot of the work that we did.

In the framework of looking at the published materials prepared at the FHFB, we identified what we viewed as five major areas which raised issues. The first was an area, the accounting tax and regulatory accounting, where we identified a number of issues that will need to be resolved for members, for Banks and members to evaluate importantly their accounting structures, tax implications of the conversion from today's structure to the structure that is mandated in Gramm-Leach-Bliley, and also looking at also influence we believe the way members will evaluate their returns.

There are a number of open issues which PriceWaterhouseCoopers began looking at. I think that most of those are not resolved and will be resolved as capital structures are developed. We identified three points which we thought could be changed in the May 3rd release from the FHFB draft. And PriceWaterhouseCoopers today is providing comments to your staff, which will change language, we believe, in ways that will create the flexibility that we believe that you intended.

The second part of the framework that we looked at was thinking through the issue of what will the members incentives be to buy class stock. We started off from an assumption here, an informed assumption, I believe, that the banks will be looking at this economically. They will be looking at the total return that their stock provides to them. The total return will be a function of both the dividend of return on their stock plus the benefit that a member gets from the use of the FHLB services. And that benefit will vary by the nature of the organization that uses the services and the amount that they use the services.

To understand that benefit fully and to understand the attractiveness of the stocks, it is going to be imperative for the banks to develop business plans and look at accounting and tax issues to go through the issues of voting rights, which with a two class structure will need to be balanced between the class Bs and the class As, looking at different business models to run the organizations of which the concept of activity based stock we think will be important for banks to evaluate and potentially to use. And then lastly, the FHFB has proposed subclass or tracking stock, which we think could have the potential to be very useful tools in developing the structures of the stock in determining whether the incentives there will be to buy class B stock.

So in summary, the structure of the stock and the economics of the stock will determine the attractiveness. And our objective is to be sure that in our view that the regulatory framework allowed for the flexibility necessary for the Banks to achieve the best results. A comment there, I think that this works all the way through, that this restructuring is complex. There are quite a number of issues that will need to be balanced. And, too, it is not clear at the beginning that there is necessarily one way to do this, probably a number of ways of restructuring the stock. And flexibility will be important in allowing the banks to determine what mix and match will work best for the members, which gets to the third key issue raised, which is a point we have called flexibility in structuring and converting stock.

The one point there is the inclusion activity based stock allows for a lot of flexibility in terms of having the banks respond to market demands for their services. We think that the Banks have got two ways of structuring themselves, as par value stocks or can do more commonly publicly traded stock. And there will be some choices that will need to be made there, which again are complicated choices, and flexibility in doing so will help come to the right choice.

We also make a note that a pure auction process in selling the stock, where a stock is created by a Bank and a Board of directors, and members are told tell us how much you want of this at a given price. The situation is more complex than that, and we'll need a more iterative process to build business plans and governance structures that work with members' expectations. And we see it from an investment banking perspective as an elongated book-building process to determine what a clearing price will be for stock.

In looking at the Federal Home Loan Bank stock and earnings capability over time, leveraging capital as fully as possible within the boundaries of the regulatory limits of safety and soundness is a valuable exercise from an earnings perspective. The proposed regulations introduced the concept of callable capital. We can mend the creativity associated with callable capital, recognizing that there is a fair amount of work to be done to determine, particularly from an accounting and regulatory perspective, to determine the ultimate value to members in the Banks of callable capital. More work needs to be done.

But we also caution that from an optics (phonetic) perspective, callable capital could have the impact of creating questions about how the home loan capital structure looks on a comparable basis to other kinds of organizations. And we think that if the ultimate end is substantive, it can be explained. But it will have to be developed with a view that it would need to be explained to a number of different constituencies, including the CO investors.

The last point that we would make is we see as a framework that the Banks will need to move promptly to develop the plans that we have discussed, the need for business plans, and working through the open issues to develop a sense of certainty of how a stock will ultimately work and behave, and what the earnings dynamic will look like. And incorporated in with that will be the array of asset choices the Banks will have the opportunity to make.

I would leave this with a couple of points. One is the reminder that I have made a couple of times that flexibility is going to be important to match up with the complexity that is inherent in the shift to a two tier capital structure. We mentioned four items that where we thought more flexibility in the regulation, post-regulation, would be useful. One is three of them are being dealt with that I mentioned before by PriceWaterhouseCoopers of your staff. A fourth is in the area of voting and governance, where we believe that while the 50 percent limitation that you proposed, a minimum for the class-B holders, makes economic sense.

We think it is possible that a more complex governance plan that would allow for 50 percent being the voting rights for certain types of issues, but potentially super-majority for other types of issues; also the potential for class A owners to have kick-in voting rights if they don't receive dividends over some period of time. I'm not being prescriptive about these. These are just options that would be useful for consideration that potentially the 50 percent limit would make it hard to consider. So we recommend the 50 percent limit be taken out in the current draft.

And then I would just like to make a handful of points of things that we think will receive lots of consideration and should receive lots of consideration from you and others, and that would be the issues of callable capital, the conversion auction process, voting and governance, the trading of the stock, which as we mentioned in our meetings with you and in this presentation, is unlikely, given the nature of the organization and the limited number of people who own the instruments, to be particularly liquid; and ultimately, the issue of activity based stock.

That's the end of my remarks.

MR. MORRISON: Mr. Lewis, do you want to add anything to that?

MR. LEWIS: Sure, Mr. Morrison. First, I would like to say that Mr. Watson has summarized quite well the approach we took in terms of collaborating with him as he worked with the Finance Board and the System in reviewing the draft regulation and the other materials. I would add a few things from an accounting and tax side.

First, the uncertainties surrounding the ultimate capital structures at this point preclude the conveyance in any sort of firm opinions on these matters, but our role really here was to try and raise issues for consideration by the Board staff and the Banks as they try to mold this regulation.

There are also some external factors that are occurring that we have talked about with the Finance Board staff as well as the Banks that will also affect the ultimate judgment on accounting and tax matters, and they include the fact that the Financial Accounting Standards

Board is in the process of preparing to release for comment a statement on accounting for liabilities and equity to clarify the attributes that should exist in financial instruments to have them characterized as either liability or equity instruments. And the outcome of those deliberations and rulemakings by the FASB will have an effect ultimately on the accounting that the System will use to account for these instruments that are being developed under this regulation.

The second is that the current accounting by members for FHLB stock is governed by the AICPA's bank audit guide. That process evolved as a result of FIRREA and the need for members and their accounting firms to have guidance as to how to treat the unique aspects of FHLB stock. And it has been our recommendation that the banks anticipate the need to change that guidance as your capital structure changes and that they work with the AICPA on ways to ensure that the guidance is current and is relevant to the ultimate structure that develops. So those two outside influences are important.

The other key considerations in finalizing views on accounting and tax matters will really rest with the development and finalization of capital plans by the Banks. As Mr. Watson mentioned, the regulation's objectives is to provide for flexibility, we believe, in allowing the Banks to meet the requirements of the law and the regulations, but also to do that in a way that is best suited for the Banks themselves and the members. And as those capital plans are finalized, and the options inherent in those decisions are also finalized, then it will be time, or we will be able to decide what accounting ramifications there are of those decisions.

Obviously, we won't look to make those decisions after the fact, but rather as people feel they have got a capital plan that is the one they are going to go with, well, then we'll be able to work with them to try as best we can to give opinions on how those capital plans would be implemented by both members and the system.

The other important consideration will be the form of what I'll call transition from the existing shares or stock to the new classes of stock. The form of transition will have important considerations, particularly from a tax standpoint. So it will be as soon as it is clear as to whether or not there will be a common form of transition by the Banks or whether Banks will have individual forms of transition, it will be important to assess the tax aspects and accounting aspects of those forms of transition to see whether the accounting results would be and to also decide whether one form of transition is a better option for both the Bank and the members at that point.

Mr. Watson also noted the fact that the callable capital rules have some unique considerations. First, callable capital, as I have described it, as we have had discussions here with the staff, I think when you come to unpaid capital, there is a range on accounting rules that could possibly apply. On one end of the range are rules that would apply to simple commitments that have been conveyed by the potential investor. On the other end would be rules that would apply to more firm commitments, such as subscriptions or notes, et cetera.

And so as we have looked at your intents with respect to callable capital, we have had discussions with you about how those rules would apply, depending on the circumstances that would surround the way you have actually structured those instruments.

Also important is the treatment that for regulatory capital purposes that the members will receive for their interest or investment in the Home Loan Bank system. Currently, there are rules specifically on point as to what risk rating would apply to the current investments that members have in the System. It will be important, I think, and we have observed it will be important for the Banks to have discussions with the bank regulators for the commercial and for banks and thrifts to understand whether or not there would be any effects of the changes, either in the two tier structure itself or a callable structure, if such was the case, so that people could assess the impact of that as well.

While that is not a matter that really we are in a position to give an opinion on because the regulators are the ultimate arbiters of those rules, it is something that I think will be an important decision for both the members and the Banks as they go forward.

That's a summary of the discussions we have had, and we'll be pleased to talk to you about any questions that you might have.

MR. MORRISON: Thank you. Questions? Mr. O'Neill.

MR. O'NEILL: Regarding the costs versus the benefits of the System, do you find that in deciding whether or not to purchase class B stock members will consider both the value of services they receive from the Federal Home Loan Bank and the potential dividend? We have debated, but never have reached closure on the appropriate balance between the value of services such as advances, pricing, and the dividend yield. What is your view of that balance, if you have one?

MR. WATSON: My view is that in a cooperative environment, there is no right answer, and that it is the responsibility of the Board of directors of each cooperative organization to set that balance for themselves. I think it is likely that a financial institution owner of a stock will be looking for a dividend that covers its cost of carry-on stock, but that it would also look very closely at the value of the services, and we look at the two as a combined package. So the division of those two issues is one that members will put back together ultimately when they review the returns.

MR. O'NEILL: Kind of a follow-up question on that is assuming advances in other products such as MPF remain competitively priced, what rate of return will class B stockholders expect on their stock investment? For simplicity, let's suppose that class B stock is risk rated 100 percent on members' balance sheets. Do you have a view of what kind of return they would expect?

MR. WATSON: Our assignment so far has been to look at the framework of these issues relative to the regulatory work, and we have not developed a set of expected returns at this point for members. I do think it would be influenced significantly by the structure and a business plan of the home loan bank and the level of risk in the stock related to the return of the stock. And I think that members will look at their own returns to generate proper returns for their owners, and they'll use in part basic return on capital analysis, and they'll look at the returns available to them on comparable instruments. And in that evaluation, they'll look at the combination at both the dividend plus the value of the services.

MR. MORRISON: We should clarify, you would agree, I take it, that their return on equity, their equity, in Federal Home Loan Bank stock is a leveraged return based on their own capital holding. Again, it is kind of, their stock, in other words, if one were to compare the members of the system and their legal leverage with the average investor in equity and their leverage, that these institutions have special leveraging powers that are not generally available.

MR. WATSON: You are assuming, which I think I am, that the class B stock in likelihood would have a FFEAC 100 percent risk rating?

MR. MORRISON: Well, whatever the risk rating is.

MR. WATSON: Yeah. I think it would. My answer to that would be dependent on the risk rating. And if the risk rating were 100 percent, I would answer the question yes. With 20 percent, I would also say that in terms of the risk rating that members are going to look at the risk rated return on the stock. We believe that more will look at the stock with respect to the leverage ratios being a constraint as opposed to the risk rating. But they will probably look at both, and some will go on to look at the economic returns, which would be more of a pure return on risk kind of analysis.

MR. O'NEILL: The report states that earnings will depend on the scope of the allowable investments. Can you quantify how much each of certain variables would have on the economic attractiveness, things like the collateral provisions of Gramm-Leach-Bliley or the tax consequences of a structure or the accounting treatment or the consequences from new community mortgage? Is there any way of kind of factoring what will really matter in the attractiveness of the stock?

MR. WATSON: I think the attractiveness of the stock is going to be a combination of the elements that you have just described plus the business plans of the banks. They'll take into account some facts. They'll take into account some assumptions about what the future markets and opportunities will be. They'll take into account potential pricing of Federal Home Loan Bank services. They should take into account the competitive dynamics. I also think that the attractiveness of the stock will be influenced significantly by the governance structure and voting rights of the members.

MR. O'NEILL: Some would argue that there are no limits in place yet on investments. But I think everyone would agree that there is the perception that either limits do exist or that they are forthcoming. Does this perception factor into whether members will buy class B stock?

MR. WATSON: Investors will take into account the limitation on the potential assets that they can buy or the potential for assets that they can buy, or services that they can undertake to be limited. The perception of that could be a determination. And I think that in the analysis the investors/members would look at what potential they would believe there would be in the absence of specific information, they would make guesses as to what limitations there might be, and then they would look at the economic impact of those limitations.

If the impact of that was significant limitations on earnings capabilities, they would put that in significantly into their analysis. They could also do that analysis and find the impact was de minimis, in which case the impact would be substantially less.

MR. O'NEILL: With the Finance Board's recently proposed regulation defining core mission activities, there is an implicit assumption that acquired member assets such as MPF would generate profits approximating those earned by mortgage backed securities. Are you familiar enough with MPF to make a judgment on that assumption?

MR. WATSON: We're certainly familiar with MPF, but we haven't done, I think the rigorous analysis necessary to compare MPF to mortgaged-backed securities.

MR. O'NEILL: It seems to me that this is a critical matter because by virtue of our final regulation, on the Federal Home Loan Bank's strategic business plans and the proposed regulation on core mission activities, you are compelling the Federal Home Loan Banks to include in their capital plans business models that exclude mortgage backed securities and other non-CMAs from the list of possible earning assets. In your opinion, is this a prudent decision on the part of the Finance Board?

MR. WATSON: We haven't annualized the full impact of the CMA. Let me rephrase this because there is nothing written down about it. We haven't analyzed the potential impact of imposition of CMA limitations on the Banks. I think that in an environment of uncertainty, injecting uncertainty into earnings and business models certainly has potential to detract from the value of the stock that is being sold and could make it harder to sell.

MR. O'NEILL: In your opinion, is it better for us to hold off on implementing core mission assets or other mission activities within the Federal Home Loan Bank System, which some might perceive as being earnings constraints, until after the capital restructure?

MR. WATSON: I think that the FHFB could make some beneficial actions to ease uncertainties around the valuation, the inputs that would ultimately be necessary to value the stock from the point of view of the B members or the A members. And so actions that would relieve uncertainty about asset choice would be positive. If those actions eliminated asset choice, provided certain unlimited asset choice, that would certainly be a negative. If the uncertainty just lifted provided clarity and not a break in asset choice, that would be a positive.

MR. MORRISON: You are not suggesting that a federal agency charged with defining a mission and regulating the mission of a GSE should allow anything to go on if it generates positive earnings, that it doesn't have a role to make those judgments, right?

MR. WATSON: No. I'm saying from an investment perspective if the value of an instrument, a stock, is more valuable if it has more choices than less choices. I'm opining on the policy dynamics. I'm opining from the financial returns.

MR. MORRISON: Right. Because they are obviously, well, just to take a for instance. The statute would permit the Federal Home Loan Banks to own various kinds of equities, and the Finance Board has historically made a judgment that except for a very narrow range of targeted equity investments should not invest in equities. Obviously, equities have over time a higher rate of return than other investments.

I am just trying to understand, are you suggesting that because a higher rate of return always would make a more attractive investment for an investor, that judgments such as that should be suspended in order to boost the earnings for the sale of the stock, at least the potential?

MR. WATSON: Two points to answer that question. I think that what I haven't been clear on, I would like to add the focus of investors will be return on return relative to the risk to risk, so investors will be looking for high returns for higher risk and low return for lower risk, with the assumption that there is an efficiency curve on return relative to risk. So investors would look, even though they would get higher returns for stocks, they would evaluate that relative to risk. They would look at mortgage- related risk relative to that risk. They would look at advanced risk relative to that risk and other risks that they would have.

MR. MORRISON: And that all assumes that would be risk based capital structure tracks the risk.

MR. WATSON: That's right. And I'm definitely making that assumption, right, that you know, proposing a sophisticated model for evaluating asset risk. And the other part of the question, I recognize that the Federal Home Loan Banks are chartered by the government with public policy benefits, and recognize that choices need to be made around public policy activities. That being said, I think within the range of public policy activities, there are assets which are more attractive and less attractive. And I think that Boards of directors have responsibilities as well as the regulator at helping in determining which of those activities can meet the requirements.

MR. MORRISON: And when you say within that constraint, obviously, there is a normative judgment to be made by this Board as to where to draw the circles, what is inside and what is outside. Given that that is a judgment that can be made now or can be made later, I hear you saying that certainty, more certainty, more information about what judgments are likely to be is a positive. Obviously, there is a range of choices, and you are arguing for broader rather than narrower range of choices. But I heard you say that within any set of choices for doing business plans and selling the stock, the more information about what the likely choices are, the better. Is that what you meant by certainty?

MR. WATSON: Yes.

MR. MORRISON: I mean, there is no such thing as certainty in life, but there is more rather than less certainty.

MR. WATSON: I think that, yes. I think that if it is known, the decisions, is known by the FHFB, for instance, that decisions on asset choice would be made some time in the future, with certainty, I think it would be, even if those were limiting choices, I think that information would rather be known by investors today than later, if there is certainty there. And I think that I can understand in today's environment why members would be potentially concerned about what certainty there might be related to asset choice, having seen the FMMA, understanding where, at a point in time, the Board was going.

And I think that the introduction of the CMA and the definition of core mission assets is, I believe, fanatically in sync with the FMMA. And so there is uncertainty, I think, gets introduced into the System, which I think is there, and it will provide a sense of caution on the part of investors.

On the other hand, I mean not on the other hand, but as a point of comparison, I think that uncertainty exists in most if not all equities of regulated institutions where regulators can make decisions on a forward looking basis that influence the value of a stock. But the degree to which that uncertainty is folded into the stock is a function of investors' perception of the range of likely actions by the regulatory body, which is a guess. Maybe sometimes it is an informed guess, but a guess about motivations and change over time through administrations.

MR. O'NEILL: And is there any way of knowing, or would you hazard a guess, how much easier this proposed capital rule would be to pass if there were no real or perceived limits on mortgage backed securities?

MR. WATSON: I don't know. I would say that there are other issues which I think will be very high in their priority in the investors' minds. Amongst those will be the governance structure, the tax and accounting issues. And I think in many cases, the ability to implement activity based stock.

MR. O'NEILL: This one is for you, Bill. I know that PriceWaterhouseCoopers has been engaged to deal with both tax and accounting issues. Briefly describe what issues you have identified so far, and have you come to any kind of conclusion, or is it just too early for that?

MR. LEWIS: I can start off by saying that we really haven't been able to come to tentative conclusions or conclusions of any sort because of the fact that, as I mentioned earlier, there are a number of uncertainties, both related to the eventual development of capital plans and transitions that the Banks will opt for, and the external factors that I alluded to earlier.

And, however, that having been said, we have been able to identify a number of issues that we think need to be considered by the System and will ultimately have to be considered by the members as they make the choices that are going to be before them in terms of how they are going to implement these changes.

The first issues that is out there is the fact that there was a change in the tax law in 1997 which could potentially have an effect on whether or not the exchange, and I'll use that term very broadly of the existing stock by members for the new forms of stock will qualify as a tax-free transaction. And essentially, those provisions which are in Section 351G of the tax code set some standards that would in some cases not permit certain stocks to achieve tax- free treatment. And there are certain attributes that already perhaps, by virtue of the statute, could accrue to the stock that we are talking about that the System would ultimately issue, the Bank System would ultimately issue, which could perhaps not allow those stock transfers to qualify for tax free.

The put-right that the member would have is the most important issue, and the fact, too, that if the dividends are tied, it could also be an issue. An offsetting consideration, though, is that the ability of the investee in that stock to participate in growth, the relative ability of them to participate in growth, can be an offsetting consideration.

So the reason why you can't conclude at this point is that until a capital plan is developed by a Bank that considers those elements and the mix of those elements is assessed in that capital plan, you wouldn't be able to make a determination. But the fact is that element of the tax law will at least raise a question about whether certain of these transactions can receive tax free treatment.

Another issue that we have discussed is what the ultimate accounting by the Federal Home Loan Banks will be for these shares on a go forward basis. Currently, the stock in the System is classified as capital. It is permitted by general accepted accounting principles. The change in the form of stock of a system will have to be reevaluated under those accounting standards.

The existing accounting standards would be applied would depend on the ultimate structure and the attributes that the individual pieces of stock would have. So, for instance, things like the preference in dividends, the preference in liquidation, the tax treatment, frankly, and other qualitative type considerations such as voting powers and influence can have an effect, and rights to corporate growth, participation in other corporate activities will be the types of things which will determine how a member will account for those investments as whether they are debt instruments or equity instruments for the member, and also how the Banks will account for those instruments, as to whether they are debt or equity instruments.

So again, it will depend on the capital structures that are ultimately developed. However, the extra consideration will be the fact that by the time this change is implemented, we will be likely to have new accounting standards from the FASB in this area. So it will be important that they be watched by the Banks and the members as those standards develop so that they can be considered as the capital plans are ultimately developed.

Another issue that we considered was the accounting ramifications for the callable stock. As I mentioned earlier, there is a range where you have nonpaid in capital as to what the accounting treatment can be, one end of the range being if it is pure commitment, it would be not recognized by either the investor or the issuer; the other range being if it was a well-secured, short-term payable instrument, there is a possibility of recognition. So we have pointed out to the Board staff and the Banks that we have talked to that the way this callable feature is ultimately implemented, along that spectrum of accounting possibilities will guide the decision as to what the proper accounting would be.

And as you mentioned, there are also regulatory considerations, as I alluded to earlier, for risk based capital purposes, which really are going to have to be the ultimate decision of the bank regulators.

MR. O'NEILL: Winthrop, you recommended that our capital regulation provide the Federal Home Loan Banks considerable latitude in designing our capital plans. By providing that latitude, is it conceivable that we will have 12 different capital plans from the Banks? Is this problematic? Is it necessary for the 12 plans to be substantially similar?

MR. WATSON: I think it is possible that you have 12 different capital plans. I think it is unlikely that you are going to have 12 all completely different capital plans because I think there are a handful of key drivers of choices, from structuring economic choices and governance choices. In terms of them all needing to look alike, I'm not sure that they do all need to look alike. But I think that at this point in time, I think that the approach the FHFB has taken to allow the Banks to make choices is the right set of choices.

There are issues that I think go between the various Banks, between the 12 Banks. And I think that at this point in time, it makes sense for the Banks and the members to come to the conclusions themselves about which issues have the potential to be limiting, and if so, to fix them themselves.

MR. O'NEILL: I would agree with that. I guess the only problem is that we have several big bank holding companies in several different districts, and if you have different rules, maybe there will be some districts that they would get out of, and others that they would flock to.

MR. WATSON: That's possible.

MR. O'NEILL: Do you have any suggestions or can we in the Federal Home Loan Banks go about communicating to members, rating agencies, debt investors FFEAC as we work to finalize this reg? One concern I have is misinformation. For example, with the concept of callable capital, you state that it has attractive attributes but may pose political problems for the System. I think it would be worthwhile for the concept. And I am concerned about the marketplace overreacting. Should we make it abundantly clear in our preamble that this regulation is one issue that we are undecided, but would welcome insightful comments?

MR. WATSON: Yes.

MR. O'NEILL: Are there other issues other than callable capital that you would put in that category?

MR. WATSON: I mentioned initially that I thought that there was enough complication around all of these issues that inviting comment on major issues and welcoming comment on other issues would be very valuable. Areas of complexity, many of them very beneficial for the Banks, would include activity based stock, the conversion of auction process for converting the stock, the voting and governance issues, issues around the tradability and liquidity of the stock. And my last point was callable capital.

Certainly, I think constituents should feel free to and then I would expect the FHFB would take those comments seriously. In the discussion, you have indicated that that is the intention.

MR. O'NEILL: Is there a problem with putting in that in the preamble so that we highlight the issues.

MR. MORRISON: All of those items are going to be discussed, although I'm doubtful that callable capital will actually be in the rule in any particular form.

MR. O'NEILL: The report states at one point that governance structure should provide the ability to deal with conflicts between class A and class B shareholders since there would strong incentives for each to gain the other. The report lists two gaining possibilities. Are there any more concrete examples of potential gaining, and also what you had in mind when you speak of governance structure?

MR. WATSON: By governance structure, I mean the structure of voting rights and Board of directors. As I mentioned earlier, you could have a simple structure as opposed in the May third materials that we received, which proposes 50 percent for the B owners, which as I mentioned before, I think might ultimately be the way it plays out. But you could add complexity to that through adding super majority rights for certain classes, kick-in rights for certain classes and various situations.

Any time you have got a situation where you have got some members owning instruments with one set of rights, other members owning instruments with another set of rights, you have the potential for conflict between them, and a governance structure is one way to help to have a framework and a form and a process for those conflicts to be resolved.

MR. O'NEILL: Is there any other way to resolve some of those conflicts other than the governance structure?

MR. WATSON: The governance structure will be a very important one.

MR. MORRISON: But isn't it true that the original structure of rights can resolve many of the questions? That is to say, one of these two instruments that partake of fundamentally two ends of the spectrum as to who is junior and who is senior in terms of the risk. And the basic decision to recognize in the governance structure the need to protect in comparison to those risks seems to me to be the fundamental choice, whether it is made here by us. You have suggested that we withdraw from a few of the conclusions that flow almost like day from night from the fact that class B shareholders are both the upside and downside senior, junior rather participants.

MR. WATSON: Yeah.

MR. MORRISON: And we will probably take your advice in that regard. But it does seem that there are some economic realities about how these things have to be, no matter how many bells and whistles you attach, there are eight directorships available under the statute, and there are not an infinite ways to structure who gets to elect eight people.

MR. WATSON: That's right. And I think my point about the complexity stems from the complexity being generated by the statutory requirements as to how the class A/class B structure will work in the whole context of a reorganized Federal Home Loan Bank. And I'm presuming that the statute holds, but then there are potential conflicts that are created by the statute, which can be resolved, which I'm not sure can always be resolved if the framework for that resolution through a governance structure. I thought you might have been saying earlier that, you know, another form of solving those issues is regulatory structure.

MR. MORRISON: No, I wasn't saying that. I was saying quite specifically that I think this isn't nearly as complicated an economic and governance problem as it is a political problem, and that the desire being reflected in having us not occupy the field on this question is one that is not primarily driven by economic analysis, that we have a long history in the System of institution,various charter types, geographical boundaries, sizes, and other things as determining who shall have power. And the Congress has essentially thrown that over in favor of a more economic power kind of System, and that the resolving of that transition probably won't work very well if the political overwhelms the economic because I doubt that people will buy things that they can't protect, and that where their economic interests is. I mean, and you have talked about many kinds of uncertainty, but I sure wouldn't want to buy a stock, a common stock, where the Board was all elected by the debt holders. And that is essentially what we are talking about here as to how those things fall out.

MR. WATSON: That's not what I am recommending.

MR. MORRISON: No, no. You're recommending that people decide.

MR. WATSON: Right. I'm acting under the assumption that ultimately economic choices will prevail in terms of attracting B stock.

MR. MORRISON: Yeah. And I'm just suggesting that there was a time in the legislative process where an attempt was made to resolve this problem legislative. And the legislative resolution was stopped by political considerations, which didn't take account of the economic changes. And I think the same is going on as we speak.

MR. WATSON: I understand where you are coming from, in this environment.

MR. O'NEILL: You underlined at several points how you have to have flexibility in balancing class A and class B issues, such as voting rights. As a safety and soundness matter, is it preferable to say that as a matter of law, class A must have some voting rights so that each member will have some say in the System?

MR. WATSON: I think that that is for the Board of directors to decide as they develop their governance plans.

MR. GINSBERG: Can I ask for a clarification on the question? You said as a matter of law. So is your question about Gramm-Leach-Bliley and what it requires for the benefit of class A shareholders in participation of the governance structure?

MR. O'NEILL: No. What I guess I am saying is with our capital regulation, should we say as a matter of safety and soundness that both A and B should have some voting rights, some say in the System?

MR. MORRISON: Well, I assume we got the answer to that. The answer was no. The answer was let the Boards of directors of the Banks decide that question. And as a matter of law, our advice so far has been that section 7, to the extent that it makes any particular requirements on this, makes none because it is being implicitly repealed by the elimination of stock required under section 7 and section 6. So essentially, we are free to empower the Banks to decide these questions as a matter of the legal question.

So the advice that I hear is have the Board keep that question as open as possible within the legal constraints, and that what we hear from the Office of General Counsel is we have generally, except for the size of the Board, which is not changed by the statutory changed, we have pretty broad discretion to grant, and the recommendation is that we grant it. And certainly my inclination is to present a proposal that does grant that kind of flexibility.

MR. O'NEILL: Your report refers to activity based stock. In the opinion of J.P. Morgan, if you were creating a capital structure for the Federal Home Loan Bank System, would you recommend that activity based stock be available for members? What are the pros and cons of having such stock for the system?

MR. WATSON: Yes, I would recommend having activity based stock. The pro is that it is a useful technique to manage the demand. It is a useful technique for allowing the Bank to capitalize itself over time to match the demand for its products and services as they flow from their member communities. The downside, I don't think there is a downside about the concept of activity based stock. There are complexities of implementing activity based stock, and there are complexities in trying to meet the demands of a community such as the Federal Home Loan Banks for these services without stock, only different complexities.

MR. O'NEILL: Another point, the report refers to callable capital. And again, in the opinion of J.P. Morgan, if you were designing a capital structure for the System, would you include callable capital, the pros and cons, if you did include callable activity, would it be fully secured or not?

MR. WATSON: In terms of the approach with callable capital, I would proceed exactly, I think, as you have in your regulation, draft regulation, that we have reviewed as of May third, which provides the opportunity to evaluate callable capital.

MR. O'NEILL: The reports states that the members' overall return on stock committed to the Federal Home Loan Bank would improve if it could be invested in funds set aside for Federal Home Loan Bank callable capital in instruments that generate a higher return in Federal Home Loan Bank stock. Is this a recommendation or an opinion of

J.P. Morgan or our staff?

MR. WATSON: It is a view of J.P. Morgan, the view would be refined relative to the accounting and FFEAC requirements, and it would relate to the nature of collateral that would be required by Federal Home Loan Bank, by a member for that callable stock, and the ultimate value of that comment would go to how the member would determine its overall return on home loan capital.

MR. O'NEILL: When you refer to instruments that generate a higher return, what are you talking about there?

MR. WATSON: If you think about collateralizing, why would you collateralize callable capital if callable capital existed? You collateralize it so that in the event that the FHLBank called the capital, that there would be certainty that there would be cash available to be called. And then there would be a choice as to what types of instruments would be available as collateral. Some organizations require treasuries. Others require other high quality instruments. And depending upon what mix of instruments are required for collateral, those instruments would generate different returns to the member holding.

MR. O'NEILL: The report recommends a book building process for class B stock and recommends symbolic leadership needed for a more refined option process. What do you mean by book building and symbolic leadership?

MR. WATSON: As I mentioned in my opening remarks, we think a pure auction process is inappropriate for the complexity of the security, and it is not commonly used in selling stocks But we think a process which is a variation on the process for IPOs, or even better, for private equity, in which a process is undertaken to define the structure and economic attributes and governance of a stock instrument, and then major investors are given a chance to review the stock and give indications as to what price they would buy it and how much, and often have significant input into the governance structure or the business plan.

And often that is a very iterative structure, iterative process, in which, in financial jargon, a book is built of potential buyers who will buy certain amounts of certain terms. And that is the process that I would argue would be important here. But since this is the Federal Home Loan Banks, you would want to be sure you had a process in which every member felt they had an opportunity to buy at terms that seemed reasonable, given the economic and structural constraints. And there, I think, in terms of the book building process, it will be important that members who are leaders and viewed as leaders will weigh in and be available to buy the stock to symbolically indicate to others that they think the structure and attributes of the instrument would be fair.

MR. O'NEILL: The report refers to the term reliant members. Can or will reliant members change, become nonreliant over time?

MR. WATSON: We make a comment about members who are, we use the phrase reliant members, but members who actively use the home loan services because the economics of those services are more attractive to them than other alternatives. And I think that over periods of time, members can switch their sources of funds for the advanced business or choices for selling mortgage risk. And some of those choices will be more or less expensive, and members can over time make adjustments. Those adjustments could have positive or negative economic consequences.

MR. O'NEILL: That is all of the questions I have. First, thank you, both of you, for allowing me to ask the questions. But I think that this rule that you have right now does have a lot of flexibility for the Federal Home Loan Banks. And I think that that flexibility is absolutely essential. So I hope that that continues throughout, but I really appreciate your giving me the opportunity to put these questions on the record.

MR. MORRISON: Mr. Apgar, any questions?

MR. APGAR: No.

MR. MORRISON: I just have a couple of things. There were in your presentation four specific recommendations, which I guess it would be fair to say was one was yours and three were PWCs.

MR. WATSON: That's effectively right.

MR. MORRISON: And PWC is providing some language, as I understand it. And the first one we discussed at some length, which is the voting rights issue.

MR. WATSON: Yes.

MR. MORRISON: And the bottom line there is it may come out the way we voted, but let's let the process get there rather than prejudge the process. Is that fair?

MR. WATSON: On the voting rights questions?

MR. MORRISON: Yes. In other words, it may very well turn out.

MR. WATSON: Yes. I'm sorry, right. The reality

(Simultaneous discussion)

MR. MORRISON: Is likely.

MR. WATSON: Yes.

MR. MORRISON: Or some variation of it.

MR. WATSON: Yes, right.

MR. MORRISON: But it would be better to let the process find its own level.

MR. WATSON: Right. That's my view.

MR. MORRISON: Okay. And secondly, with respect to callable capital, you have identified as having some potential. But you have also identified it as problematic in both optical terms and also in complexity that you attached.

MR. WATSON: Don't know.

MR. MORRISON: Accounting.

MR. WATSON: I think they are open. I'm not sure that those are necessarily problems. I think they are open issues on the accounting front that when those open issues are better understood, the attractiveness of callable capital to the member will be clear.

MR. MORRISON: But you are not in a position today to say either, number one, that it is necessary to the selling of class B stock.

MR. WATSON: No.

MR. MORRISON: Or class A stock, nor that there are potential political and substantive problems with its implementation in the accounting area, for instance, as to whether or not it's, you don't know.

(Simultaneous discussion)

MR. WATSON: I think it will raise political issues, and I think it will bear on their accounting, their accounting uncertainties. All that being said, I do think that the ability to leverage the terms will make the stock more attractive to members if it is done within a context of the safety and soundness, the risk bearing of capital requirements that you are imposing and the Gramm-Leach-

Bliley capital requirements.

MR. MORRISON: And so, I mean, at this point, having discussed your four recommendations and what we have just discussed on callable capital, is it fair to say you don't see any showstoppers in the outline that you saw?

MR. WATSON: I don't see any showstoppers in the outline I saw. I think in all honesty that significant issues are likely to come up during the comment period as a broader group of people, particularly the members, will have a chance to focus on the specifics that you are introducing in the regulatory process and have a chance to really think about them. And I think that it is highly likely that people will come up with ideas that collectively you and us haven't fully considered in the period of time that we have had to consider them. So you encourage you, and I have heard you be open to this in the preamble and during the comment period, to be open to the issues that people bring forward.

MR. MORRISON: And that being said, and everything else that you said, my conclusion from your report, most of all, is that the creation of business plans by the Banks and they themselves understanding the potential ways in which they can operate with new capital, can't start soon enough so as to provide input to the ultimate decisions rather than be delayed until after there is a reg, and then there is a capital plan that doesn't quite work because something in the reg wasn't thought of before.

MR. WATSON: No. I argue that if the Banks are able to present, they don't necessarily need to be, you know, 100 page bound, perfect business plans, but an array of business.

MR. MORRISON: Fifty pages?

MR. WATSON: Of business choices and preliminary views on what economic returns choices. And it would give members the chance to think through the issues. And I think that at the next round, the members may be the ones who come up with further constructive dialogue about the effectiveness and the implementability of the regulations.

MR. LEWIS: And I might add from an accounting standpoint that that is a critical element of getting to more certainty on accounting decisions from a couple of perspectives, the ones I mentioned, but in addition, sort of the comment that Director O'Neill made about a commonality is the explainability of the capital structures in your combined financial statements is something that has to be considered so that there is credibility and explainability in the marketplace as to how these broad differences, they are all presented in a combined way.

The second, as I indicated, you know, the AICPA in many respects assisted the member of the Federal Home Loan

Bank System by developing a common set of guidance for all of your members as well as their auditors as to how to account for the investment in the Federal Home Loan Bank System. And because the determination in these capital plans will dictate how that accounting will occur, the uncertainty surrounding that for all of the members and for all of their independent accounts can be more quickly resolved as those capital plans are cemented.

So I would also add my view that quick movement on capital plan development will be in everyone's best interest from an accounting standpoint.

MR. MORRISON: Okay. Anything further from my colleagues? We thank you both gentlemen for spending this time with us and for the hard work that went before you did that. And we expect to see more of you. Thanks very much. The meeting is adjourned.

(Whereupon, at 4:08 p.m., the meeting was adjourned.)

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REPORTER'S CERTIFICATE

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CASE TITLE: FHFB OPEN MEETING

HEARING DATE: MAY 17, 2000

LOCATION: Washington, DC

I hereby certify that the proceedings and evidence are contained fully and accurately on the tapes and notes reported by me at the hearing in the above case before the

Date: MAY 17, 2000

Jan M. Jablonsky

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